

**A STUDY OF PUBLIC POLICY INFLUENCES UPON  
THE DEVELOPMENT OF RURAL ENTERPRISES, WITH  
PARTICULAR REFERENCE TO CHINA'S RURAL  
ENTERPRISES, 1978 - 1992**

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## Abstract

This study is an analysis of how public policy changes in China influenced the development of rural enterprises from 1978 to 1992. Starting in 1978, China's leadership implemented a series of economic reforms aimed at rebuilding domestic legitimacy by catching up with the industrialized nations of the West and the new industrial powers of Asia. These reforms in combination created a political and economic environment that proved conducive to the development of rural enterprises.

Despite the undoubted progress of the 1980s, changes in public policy have been inadequate, and ideological and political problems continue to prevent rural enterprises from making even greater developments. However, mounting social and economic problems, such as rural unemployment, and the economic strength of rural enterprises will push against these constraints. These conditions may force the leadership to take further changes in public policy which will allow rural enterprises to play increasingly important roles in the Chinese economy.

The thesis consists of nine chapters. Chapter One is a general introduction to the research area. Chapter Two deals with the evolution of rural enterprises policy both before and after 1978. Chapter Three examines regional policy variations for rural enterprises. Chapter Four focuses on the implications of market reform and market expansion for

rural enterprises. Chapter Five assesses the impacts of rural employment and regional development strategies for rural enterprises. Chapter Six examines financial and taxation policies towards rural enterprises. Chapter Seven and Chapter Eight deal with policies to improve the management and technology of rural enterprises. Chapter Nine draws conclusions and evaluates likely future development of rural enterprises.

## Note On Transliteration

This thesis uses *the pinyin* system of transliteration for all names, including those that are commonly known in their wade-giles transliteration in English. For example, I use Beijing instead of Peking, Zhejiang instead of Chekiang, and so on. However, when directly quoting an author or when citing book and article titles, the author's original transliteration is used.



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Abbreviations

CCP	Chinese Communist Party
FBIS	Foreign Broadcast Information Service
JPRS	Joint Publications Research Services
PRC	People's Republic of China
SWB	Summary of World Broadcasts/Far East/Daily Report
SWB/W	Summary of World Broadcasts/Far East/Weekly Economic Report
TVP	Township, Village, and Private Enterprises

## **Chapter 1 Introduction**

### **1.1 The Significance of the Study**

For many third world nations, the axiom that "big is best" seems to have been at the heart of economic development strategies. The establishment of large industrial complexes (most notably iron and steel furnaces) has been seen as the key to laying the foundations for further economic development and the creation of a vibrant domestic economy. But the evidence of recent years is that the expected economic growth and increased employment that large-scale industrialization was supposed to generate has, at best, been slow in appearing. As a result, many development economists have increasingly turned their attention to the potential impact of emphasizing the development of small-scale enterprises.

This shift in emphasis has been reflected by the actions of both important international institutions and national governments. For example, the World Bank has been steering more of its loans towards small-scale enterprises at the expense of large industrial complexes. Some developing countries have intensified their measures to support and protect such enterprises. In contrast to the traditional large-scale complexes, small-scale enterprises are thought to have made significant contributions to both

employment generation and the diffusion of skills and technology. These developments have been reflected by the growth in academic literature analyzing promotional policies adopted in developing countries for the development of small and medium-scale industries.<sup>1</sup>

Although large-scale state owned complexes continue to play an important role in the Chinese economy, rural enterprises have developed rapidly, and have become a major prop of the rural economy and an important part of the national economy since 1978. The following data clearly indicate rural enterprises' important role in China's national economy. In 1989, there were more than 18 million rural enterprises nationwide. They turned out 840.3 billion yuan in output value, an amount equal to the nation's entire 1979 gross product. The total industrial output value of rural enterprises from 1981 to 1989 increased at an annual rate of 28.6 percent, thus playing an increasingly important role in national economic development and social life.<sup>2</sup>

The development of rural enterprises has changed the old economic structure which was largely dependent on farmland and become a means by which the total output value of rural enterprises, as a proportion of that for rural society, increased from 31.4 percent in 1978 to 58 percent in 1989. From 1979 to 1989, rural enterprises ploughed more than 80 billion yuan from their profits back into rural undertakings.<sup>3</sup> Without the contribution from rural enterprises, the financial situation for education, health



care and welfare facilities in many rural areas would be worse since local governments have faced fiscal restraints.

Rural enterprises have also become an outlet for the surplus rural labour force. In 1989, some 93.67 million people worked in rural enterprises, accounting for 23 percent of the total rural labour force, or 62 percent of the increased labour force from 1978 to 1989, or half of the current total labour surplus.<sup>4</sup>

Between 1979 and 1989, rural enterprises' direct subsidy of agricultural production was about one-third of the state investment in forestry, water conservancy and meteorology during the same period, thus considerably promoting agricultural production.<sup>5</sup> In these 11 years, farmers across the country gained one-fourth of their net income from rural enterprises, and during 1986 to 1990, the proportion rose to 50 percent.<sup>6</sup> Since 1985, the net increase in taxes from rural enterprises has accounted for 50% of that in the state's financial revenue. In some areas, where rural enterprises are highly developed, local financial revenue is mainly from rural enterprises.<sup>7</sup> From 1984 to 1989, the total export value of rural enterprises reached US\$ 35.5 billion, as much as US\$ 10.5 billion in 1989 alone, representing about one-fifth of the country's total export value.<sup>8</sup>

The data such as the above show that developing rural enterprises has been a distinguishing characteristic of the rural development strategy in China since 1978. The

development of rural enterprises has contributed immensely to the phenomenal growth of the rural economy and improved living standards in China's rural areas since 1978. The development of rural enterprises has also helped to boost agricultural production itself, while changing the traditional rural economic structure from one dominated by farming to a far more diversified economy. Furthermore, rural enterprises have played a very important role in providing rural employment, increasing financial revenue and earning foreign exchange.

Chinese government policy makers are also well aware of the importance of rural enterprises. For example, a 1984 joint State Council and Central Committee communique<sup>9</sup> listed an impressive array of the beneficial consequences of allowing rural enterprises to flourish. The communique indicated that village and town enterprises are recognized as an important component of a diversified economy, an important pillar of agricultural production, an important way for the masses of peasants to achieve common prosperity, and an important source of state revenue. The development of village and town enterprises was further described as an important force in the national economy.

Given this laudative "mid-term report", it is not surprising that some Western economists have subscribed to the view that rural enterprises are well on the way to changing the entire nature of Chinese society. For example, a report in *The Economist* suggested that: "China's economy

has produced a nice twist on Mao Zedong's theory of revolutionary war. The private enterprises of the countryside are surrounding, and threaten eventually to swamp, the state-owned industries of the cities".<sup>10</sup>

The year 1978 marks a watershed in the study of the importance of rural enterprises for the Chinese economy. Before this date, the dominance of 'leftist' ideology and, equally as important, the disbanding of economic research institutes meant that no research on rural enterprises was undertaken within China. Outside China, some western economists, however, did undertake research on China's rural enterprises. The main focus of those works was rural industry, the main part of rural enterprises in China before 1978. The most important contributions to this field of study are *Rural Industrialization in China* by Jon Sigurdson<sup>11</sup>, and *Rural Small-Scale Industry In The People's Republic of China* by the American Rural Small-Scale Industry Delegation<sup>12</sup>. Jon Sigurdson focused his analysis on county-run enterprises. He examined rural industrialization within counties, giving the rationale for the various programs, an analysis of two model counties, and some estimate of how well the programs have worked. The crucial flaw in the American Rural Small-Scale Industry Delegation's work was that they interpreted what they were told, and failed to question the validity of the raw data they were given to work with.



In addition to these two books, two important articles are worthy of comment, namely "Small Industry and the Chinese Model of Development",<sup>13</sup> and "China's Rural Industries: 'Self-reliant Systems or Independent Kingdoms'" both by Carl Riskin.<sup>14</sup> The first article, published in 1971, examined the evolution and implementation of China's policy towards small and medium industry. In this article, the first four sections were concerned with the period of the First Five-Year Plan (1953-57), while the latter four dealt with the dramatic activities of the Great Leap Forward (1958-60) and the attempts to rationalize the small-industry programme in the 1960s. Riskin's second article published in 1978 mainly dealt with the roots of these events in the development of China's rural industries from the 1960s. It evaluated the impact of the Cultural Revolution on rural industrialization, and sought to place the polemics over the socio-political implications of this form of development into the context of changing objective conditions. It is necessary to mention that the scope of all these works included county-level state owned enterprises. Although this was a valid approach at the time, the definition of rural enterprises used in this study does not include county-run enterprises (see section 1.2). As a result, these earlier works have only a limited application to this study.

Since 1978, there has been an explosion of articles on rural enterprises within China. Some Chinese scholars have undertaken research on the position and characteristics of



rural enterprises, and indeed disclosed much useful statistical information. But inevitably this research was deficient in that it lacked political analysis of the development of rural enterprises because of domestic political obstacles.

What is surprising is that although Chinese rural enterprises have developed dramatically since 1978, few articles and books have been published in western countries. In the early 1980s, the only articles of note were the following: "Rural Enterprise in China, 1977-79" by Jack Gray;<sup>15</sup> "Commune- and Brigade-Run Enterprises in Rural China: an overview" by Keith and Kimberley Griffin;<sup>16</sup> and "Commune- and Brigade-Run Industries in Rural China: Some Recent Observations" by J.L.Enos.<sup>17</sup> Enos and Griffin and Griffin indicated a few of the characteristics, sizes of the commune- and brigade-run enterprises sector, and briefly discussed some of the recent changes in policy affecting this sector. Gray described the growth, the regime and some changes of purpose in relation to rural enterprises, and discussed changes in the control of rural enterprises between 1977 and 1979. However, although these authors undoubtedly made some contribution to the literature on rural enterprises in China, their publications suffered from the following limitations.

First, Gray did not draw a clear line between rural enterprises and local industry. Secondly, none has paid any attention to the private sector of rural enterprises. It

could be possible that their primary stumbling block is lack of detailed information because debate and information concerning these sectors was not published in the Chinese press until the late 1980s.

In the late 1980s, more noteworthy articles were published. Two articles are especially worthy of comment: "The Development of Town and Township Enterprises in Mainland China Since 1979" by Chen Tesheng<sup>18</sup> and "Policy, Practice and The Private Sector in China" by Suan Young<sup>19</sup>. The first article briefly discussed the theoretical basis for promoting town and township enterprises, the evolution and characteristics of these enterprises, the reasons and measures for their development, as well as their advantages and disadvantages. The second article examined the growth of the private sector in China since 1978, including the original goals of its promotion and development, and the impact of this growth on Chinese assessments of the role of private business in the Chinese economy. Without doubt, their articles have represented valuable research into rural enterprises and the private sector. However, the implications of other policy changes, such as rural employment and regional development policies, were not discussed. Policy analysis has also been inadequate.

The most important book on this subject is *China's Rural Industry: Structure, Development, and Reform*.<sup>20</sup> This six-part, nineteen-chapter volume is the result of a joint project by the World Bank and the Economics Institute of the

Chinese Academy of Social Sciences. In 1986 and 1987, the joint World Bank and the Chinese Academy of Social Sciences research team conducted surveys and extensive interviews on China's township, village, and private enterprise (TVP) sector, involving 1,174 workers, over 100 enterprises and their directors, and sixty-seven township officials. It is the first comprehensive study of China's TVP sector based on systematic empirical evidence. The survey data collected as part of the project is comprehensive and basically reliable. The topics covered in the book, such as ownership, labour, efficiency, the role of governments, and comparative perspectives, are both theoretically and practically important and relevant. However, this research is not without its limitations. First, the research has been overtaken by the pace of change within China. As this research was completed before 1987, important changes that occurred after 1986 are not included. Secondly, there is the limitation of the analysis of public policy, with no detailed analysis comparing policy before and after 1978.

Therefore, as far as the literature reviewed above is concerned, research has tended to neglect the study of the impact of public policy on the development of rural enterprises. However, public policy has been extremely important in China since it has determined not only the extent to which rural enterprises have been developed (and what prospects rural enterprises will have in the future), but also whether rural enterprises should be allowed to be



developed at all! Therefore, an analysis of changes of public policy since 1978 must be a crucial component of any analysis of the development of rural enterprises.

### **1.2 The Definition of Rural Enterprises**

One of the problems entailed in studying rural enterprises in China is that of defining what constitutes a "rural enterprise". There has been no united definition of rural enterprises, a problem exacerbated by the economic changes enacted after 1978. Before this date, the definition of rural enterprises was much broader than that used in the era of reform.

Carl Riskin gave the following definition: "rural industries refer to those industries run by the rural communes and their production brigades and state industries at sub-provincial level, chiefly those operated by the hsien (county)." <sup>14</sup> Jon Sigurdson's definition of "rural industries" was similar to Carl Riskin's. He stated that:

"rural industry is, in this monograph, not defined on the basis of size but as any local industrial unit run by county, commune, or brigade. The enterprises may be collectively owned, jointly financed by the state and collective units, or wholly owned by the state but local management. Rural industry also includes



units attached to middle schools, hospitals, and health clinics."<sup>21</sup>

Jack Gray also used the term "local industry" interchangeably with "rural industry". However, within China itself, the terms "local industry" and "rural industry" have distinctive and different meanings. "Local industry" comprised all industrial enterprises under the jurisdiction of government organs at the provincial level and below. Hence, rural industry is a part of, and does not equal, local industry.

In sum, the definition of rural industry that most western economists used before 1978 equates to industrial units run by counties, communes, or brigades. It therefore includes not only collectively owned enterprises, but even those units wholly owned by the state.

Since 1978, there has been considerable confusion within the Chinese press as to what terms to use to describe rural enterprises. The terms commune and brigade enterprises, township and village enterprises, rural enterprises have all been used at various times in various Chinese journals, newspapers and official documents. Officially, the name of "commune and brigade enterprises" was changed to "village and town enterprises" in 1984.

"In view of the fact that communes and production brigades will become town and village co-operative economic organizations, many enterprises of a cooperative nature jointly run by some households

or by households in different areas as well as many jointly operated and individual enterprises have emerged in recent years. Such enterprises will tend gradually to congregate in small market towns. Therefore, the term "commune and brigade enterprises" used in the past can no longer reflect the newly developing situation of the enterprises of this category. It is suggested that such enterprises be called "village and town enterprises."<sup>22</sup>

In fact, rural enterprises should include private rural enterprises although private enterprises were not legalized until 1988. For example, rural industry in *China's Rural Industry: Structure, Development, and Reform*, edited by William A. Byrd and Lin Qingsong, included private rural enterprises.

Even in the Chinese press, there is confusion over what constitutes a rural enterprise with the term "township and town enterprises" often used interchangeably with "rural enterprises". For example, the English language journal, *Beijing Review*, gives the following definition: "Township enterprises include industries which have been run by communes, production brigades and teams since the establishment of communes. They also include associations of enterprises set up by peasants in recent years, enterprises jointly run by various rural economic sectors and individual enterprises".<sup>23</sup> However, in the same journal, another

article gave the following definition of rural enterprises: "Rural enterprises are run by townships or towns (The people's communes before 1983), by the villages (previously production teams), by teams (previously production teams), by several households together or individual households".<sup>24</sup> Thus, in essence, rural enterprises and township and town enterprises are the same entities under different names.

For the convenience of this research the author follows the definition of rural enterprises adopted in the Chinese press. Rural enterprises or village and town enterprises include all factories and companies in industry, construction, transport, agriculture, and husbandry, commerce and catering which are operated by towns (townships), villages and individuals. It is important to note that government policy towards rural enterprises is different in terms of ownership structures of rural enterprises. Therefore, in my research, rural enterprises are divided into the following two categories according to the ownership structures of rural enterprises.

The first category is those enterprises originally belonging to communes or large production teams, which now belong to agricultural cooperatives or integrated economic organizations. In some cases, they call themselves "companies", and are generally administered by rural small town governments. In rural and small town government enterprises, there is often no clear line drawn between



government and enterprises. They all bear the clear mark of collective ownership status.

The second category comprises the private sector of rural enterprises. These enterprises can themselves be subdivided into two broad areas; private enterprises and individual enterprises. The term "private enterprises" refers to those whose means of production are privately owned and with eight or more employees,<sup>25</sup> as compared with the category of "individual enterprises" meaning a business started with private funds with seven or less employees.

Private enterprises are officially classified into the following three types: (1) Individual investor; (2) Partnership; (3) Limited liability company. Individual investor refers to enterprises managed by a single person. Partnership refers to two or more people who invest as an association, sharing joint management. Limited liability company refers to investors who are responsible to the company for a specific amount, and the company may use the entire amount of its capital to assume the responsibility of the debt of the enterprise.

In addition, most private enterprises are located in rural areas. The information in 1988 indicated that about 83 percent of the capital funds and labour of private enterprises were located in rural areas. Over 80 per cent of private enterprises were based in the countryside.<sup>26</sup> Furthermore, the government has provided the same policy treatment towards individual and private enterprises



irrespective of whether they exist in rural or urban areas. Therefore, I will analyze general policy towards individual and private enterprises instead of towards rural private and individual enterprises.

### **1.3 Research Hypotheses**

This thesis aims to demonstrate that the main stimulus for the extraordinary growth of rural enterprises in post-Mao China has been the removal of restrictions to their operations. Although the introduction of special programmes and incentives have played a beneficial role, they have only reinforced the natural proliferation of rural enterprises resulting from the removal of obstacles to their functioning. As such the main contribution of the reform era has been the creation of a political and economic environment conducive to the expansion of the number, type, and functions of rural enterprises.

After the death of Mao Zedong and the arrest of the radical "Gang of Four" in 1976, Chinese politics entered a new age. Although Mao had an intense desire to turn China into a modern industrial country, this desire coexisted with an even stronger desire to ensure that the social and cultural revolution should occur alongside (and indeed, could help facilitate) the industrial revolution. For Mao, economic development should not be seen as an end in itself,

but as a means to the more important end of the transition to a communist society.

After 1976, or more correctly, after Deng Xiaoping took *de facto* control from the quasi-Maoist Hua Guofeng in 1978, the ideological basis of decision making began to change. At the risk of over simplification, the ascendancy to power of Deng Xiaoping marked a shift from "politics in command" to "economics in command". In an attempt to "catch up" with the industrialized nations of the West and the new industrial powers of Asia (Japan, the Republic of Korea, Singapore, Taiwan, and Hong Kong), the social and cultural revolutions were essentially postponed.

As China was still a backward nation in the early stages of development, it was argued that the development of a modern industrial society must occur before the transition to communism could take place. Expanding the productive forces therefore increasingly became the base-line for any change in society. Whatever helped in economic development, including private and even foreign ownership of the means of production, should not only be tolerated, but actively encouraged. As this thesis will show, this change in the basic ideological orientation of Chinese decision making had a profound impact on the expansion of rural enterprises, although, as shall be seen, developments have been far from trouble free.

Rural reform was the entry point of the reform program. In an effort to increase rural production, the household

production responsibility system was introduced, rural markets were reopened, procurement prices were raised to improve incentives, and agricultural taxes were reduced. Without these reforms, the increased agricultural output, rural savings, and surplus labour that were a precondition for the development of rural enterprises would not have existed.

Although the removal of restrictions on the role and scope of rural enterprises has been the principal source of their expansion and development, the government has also implemented a number of specific policies aimed at facilitating further developments. These special programmes have been primarily targetted at the development of the collective sector of rural enterprise, and have greatly contributed to growth in this area. However, the key element in the considerable growth of the private sector remains the simple tolerance of their existence by a government which previously prohibited their existence.

In addition to policies directly concerned with the expansion of rural enterprises, reforms in other areas of the political-economic system have also influenced the scope and nature of developments. Of particular note are the extension of decision-making power to local governments, individuals and enterprises; the partial adoption of market mechanisms; a new rural employment strategy; and a regional development strategy based on exploiting regional comparative advantage. In fundamentally altering the



underlying political and economic system in China - not least in promoting the acceptance of the legitimate role of market forces and non-state ownership - these policy changes have significantly aided the development of rural enterprises. Indeed, the specific policy changes relating to rural enterprises could not have been implemented without such a reform of the basic structure of the Chinese political-economic system.

The overall impact of these changes has been the creation of a more relaxed environment and more favourable conditions for the development of rural enterprises. As a result, since 1978, rural enterprises have developed rapidly. As I have indicated in section one of this chapter, rural enterprises have become a major prop of the rural economy and an important part of the national economy.

However, despite this phenomenal progress, the change of public policy has been inadequate, and many restrictions to the effective functioning of rural enterprises in China remain in place. The old economic structure has been only partially dismantled, and rural enterprises still face considerable discrimination (whether they are collective-run or private-run enterprises) in the economic system. This is most clearly evident in official policy regarding access to raw materials and credits, where state-run enterprises receive preferential treatment. Rural enterprises have not enjoyed the same competitive position as state-enterprises in many other areas such as product



transport, retailing and export, and the supply of key production elements. Rural enterprises cannot fulfil their true potential within the Chinese economy until these anomalies and restraints on operation are removed.

In addition, some of the special policies designed to facilitate the growth of rural enterprises have been inadequate. Perhaps the best example here is the preferential treatment accorded to rural enterprises in credit procurement and taxation policy, which have been gradually, and prematurely, reduced.

Arguably the greatest challenge to the future development of rural enterprises in China is the fact that despite the dramatic and radical changes in the ideological basis of Chinese decision making in the 1980's, some ideological and political problems still remain. Essentially, not everybody in the Chinese political system shares the belief that rural enterprises are a good thing. On a practical level, some critics have complained, not without justification, that the development of rural enterprises has affected agricultural production, and the development of rural enterprises has polluted the environment. But even the fundamental ideological question of the acceptability of rural enterprises has not been solved once and for all. Some conservative leaders have expressed concern that the existence and development of private enterprise might lead to private entrepreneurs becoming a distinct class infiltrating the government

sector, and could finally result in the restoration of capitalism, which would change the face of socialism and the nature of society in China. Some critics have also warned against the over rapid development of these enterprises, seeing them as a threat to state owned enterprises that will result in a widening disparity between the rich and the poor and between different regions. This suspicion of rural enterprises has been fuelled by accusations that rural enterprises, and especially private enterprises, have been the source of much corruption. These ideological and political problems have been an obstacle restraining rural enterprises' ability to make an even greater development.

Notwithstanding these problems, it should be recognized that both ideological and public policy changes have facilitated a dramatic and rapid expansion in the scope and importance of rural enterprises since 1978. Despite the obstacles that remain to their further expansion, I believe that growing social and economic problems, such as rural unemployment, and the economic strength of rural enterprises will push against these constraints, and force the leadership to further reform its public policy, and allow rural enterprises to play an even greater role in the Chinese economy.

#### 1.4 Research Method and Research Plan

My study is primarily concerned with public policy analysis. There are many different definitions of public policy. For example, Eugene J. Kolb defined public policy as follows: "Public policies constitute the expression of a political system's goals and the means with which it pursues them."<sup>27</sup> Thomas R. Dye defines public policy as "whatever governments choose to do or not to do."<sup>28</sup> However, one thing is common in that if a policy is regarded as "public policy" it must to some degree have been generated or at least processed within the framework of governmental procedures, influences and organizations.<sup>29</sup> Rod Hague, Martin Harrop and Shaun Breslin<sup>30</sup> divide the policy process into the following stages: (1) initiation; (2) formulation; (3) implementation; (3) evaluation. Although the decision-making process towards rural enterprises is a very interesting issue, the primary purpose of my study is to examine how public policy influenced the development of rural enterprises as the title of my study has clearly showed. Therefore, my study will mainly deal with policy evaluation. Thomas R. Dye thought that "Policy evaluation is learning about the consequences of public policy."<sup>31</sup> Peter Jones considered that the evaluation of public policy is concerned to assess the effectiveness and propriety of policy. The narrower approach is concerned to judge a policy



only by standards 'internal' to the policy itself, this is, to deal with whether a policy succeeds in achieving its own aims, while the more comprehensive approach would invoke criteria 'external' to the policy, in other words, whether the aims to which a policy is committed are the right ones.<sup>32</sup>

In my study, I will take a comprehensive approach to analyze China's government policy towards rural enterprises. First, I will make an empirical examination of the policies themselves -- the general and specific content of policies. Second, I will examine actual or potential consequences of policies, and their immediate and long-range impact on the development of rural enterprises as well as politics and society.

The analysis in this thesis is primarily concerned with the different central government policies towards rural enterprises. However, in the post-Mao era provincial and lower level authorities have been allowed flexibility in the implementation of central policy. At certain times in certain policy areas, lower level authorities have taken on the function of actually making policy. Therefore, I will also analyze why regional policy variations have occurred.

My study mainly makes use of information and documents from the Chinese and English press. Party and state leadership speeches, documents and communiques are also important, requiring careful analysis for indications of past and future policy direction. Since 1949, the quality of



information in China has gone through three stages: (1) 1949-1958, (2) 1958-1978, (3) 1978-present.

During 1949-1958, the information in China was relatively sufficient, and as a consequence, some researchers have concentrated on this period for research purposes. For example, *A Price control, and Rationing of Key Agricultural Goods in China* by Johnson, Todd Milo (August, 1984), and *Rural Income in the People's Republic of China, 1952-1957, With Special Reference to Guangdong Province* by Peter Nolan. However, there was a distinct drop off in the quantity and quality of information contained in the Chinese press during and after "the Great Leap Forward". News reports and statistics were reduced, and replaced by an increase in rhetoric. This situation continued until the late 1970s. The period since 1978 has seen an improvement in information for both outsiders and insiders. During this period, China established more than twenty universities and colleges of finance and economics as well as economic institutes at both the national and provincial level. Many journals and books in social science were published in China, while detailed texts of government policies, and mass reaction to some policies, as well as debates over economic questions were more frequently published in national and local periodicals.

Moreover, at the end of April 1980, the PRC was accepted as a member of the International Monetary Fund and the World Bank. As a result, some statistical information

has been brought up to internationally acceptable standards. However, China is a developing and socialist country, and some data and information are still lacking. Moreover, some data is misleading. For example, some private rural enterprises registered their business as affiliated with collectively owned ones in order to gain the same advantages, while fearing policy changes and discrimination. The recorded amount of private enterprises was thereby reduced.

The author will undertake the following plan of research. In Chapter Two, the author will discuss the evolution of China's rural enterprise policy. This chapter will mainly concentrate on China's rural enterprises policy since 1978. However, in order to analyze the change of policy towards rural enterprises, a brief review of pre-1978 policy will be given. Rural enterprises include both rural enterprises of the collective and the private sectors. Since China's policy towards the two sectors has been quite different since 1978, the policy analysis after 1978 will be divided into two parts: the collective sector and private sector of rural enterprises. Therefore, in the first section, I will first provide a brief review of China's policy towards collective rural enterprises before 1978; I will then discuss China's government policy towards collective rural enterprises after 1978. In the second section, I will first give a brief review of China's policy towards individual and private enterprises before 1978.

Secondly, I will deal with government policy towards individual enterprises since 1978. Thirdly I will discuss government policy towards private enterprises since 1978.

One of the most striking features of China's economic (and to a lesser extent, political) development in the post-Mao era has been the degree to which provincial and lower level authorities have been allowed flexibility in the implementation of central policy. Since 1978 there have been relatively wide discrepancies between what the centre officially decrees, and what actually happens on the ground.

Therefore, in Chapter Three, I will address the issue of the divergence between central policy and local actions in relation to the development of rural enterprises. Having briefly analyzed the wider question of centre-local relations in the post-Mao era, I will proceed to assess the importance of five key factors in the evolution of differing local policies towards rural enterprises. These are the implications of the changes of the centre-local relations, the conflicting approaches of rival central leaders, variations in the desire of local leaders to adhere to central policy, the economic legacy in determining an area level of economic development, and the importance of unique geographical and historical factors of different areas. Although examples of divergent policy will be used from across China, debate within China itself has centred on the different approaches adopted in Wenzhou and in Southern Jiangsu. As a result, issues relating to the evolution of



local policies in these two areas will be given a relatively high profile in this chapter.

Since 1978, the Chinese economy has been divided into a planned and a non-planned sector. China's rural enterprises are highly dependent on the market. The reform of the market has played a very important role in the development of rural enterprises. Therefore, in Chapter Four, I will discuss the influence of the market on rural enterprises. First I will discuss reform measures of the market and their implications for rural enterprises. Then I will examine the effects of market expansion on the development of rural enterprises. Thirdly I will explain some characteristics of the market's use of rural enterprises. Finally I will analyze the likely effects of further reform of the market on the development of rural enterprises.

In Chapter Five, I will concentrate mainly on analyzing the implications of the changes of rural employment and regional development strategies on the development of rural enterprises. In the first section, I will discuss the implications of rural employment strategies on the development of rural enterprises. In this section, first, I will assess unemployment in rural areas. Next, I will discuss the strategies attempted for solving rural underemployment. Then I will examine the employment generated by rural enterprises. In the second section, I will examine the implications of regional development strategies on the development of rural enterprises. In this



section, first, I will analyze regional development imbalances of rural enterprises since 1978. Then I will analyze the impacts of regional development strategies on the development of rural enterprises. In the third section, I will analyze the future prospect of employment in rural enterprises and future regional development of rural enterprises.

Financial and taxation policies have also influenced the development of rural enterprises. Thus, in Chapter Six, I will analyze China's governmental financial and taxation policies in rural enterprises. First I will examine the state's credit policy towards rural enterprises and its implications. Second I will analyze China's tax policy towards rural enterprises. Third I will consider the sources of capital in rural enterprises. Fourth I will examine the fundraising process in rural enterprises. Finally I will analyze the prospects of finance in rural enterprises.

The government has adopted some policies to improve management in rural enterprises. Therefore, in Chapter Seven, I will examine how these measures have affected the management in rural enterprises. In doing so, first, I will discuss the reform of the administrative management system. Second, I will consider some of the government's measures to improve the income distribution of rural enterprises, which will include the reform of the wage system and the reform of the profit distribution system in rural enterprises. Third, I will examine government policy to promote the quality of

production in rural enterprises. Chapter Eight is used to examine China's government measures to promote technology in rural enterprises. In so doing, I will first explain the level of technology in rural enterprises, then I will analyze the government's technological strategy before and after 1978. Next I will examine the progress of technology in rural enterprises. This includes the following aspects: the Spark Plan towards rural enterprises; technological personnel in rural enterprises; cooperation in technology between state enterprises and rural enterprises and between research institutes and universities and rural enterprises. Finally I will discuss the future prospects for technological progress in rural enterprises. Chapter Nine draws conclusions, and estimates the likely development of rural enterprises in the near future.

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## **Chapter 2 The Evolution of China's Rural Enterprise Policy**

In this chapter, I will explain the evolution of government policy for the development of rural enterprises. I am mainly concerned with the development of rural enterprises since 1978. But in order to explain the change in government policy for rural enterprises, a brief review of its pre-1978 policy will be given. Rural enterprises include rural enterprises of both the collective and private sectors. China's policy towards the two sectors is quite different. Thus, the policy analysis is divided into two parts: the collective sector of rural enterprises and the private sector of rural enterprises.

### **2.1.1 A Brief Review of China's Policy towards Collective Rural Enterprises Before 1978**

As early as the 1950s, shortly after the founding of the People's Republic of China, the attitude of China's leadership towards small scale enterprises was either to overlook them, in the haste to build heavy industry, or to focus more on the problem of freeing them from the control of petty capitalists.<sup>1</sup> At that time, rural enterprises were underdeveloped. The "five kinds of artisans" (the carpenter, bricklayer, blacksmith, mason and bamboo stripknitter) and

the "four kinds of mills" (the power mill, bean-noodle mill, oil mill and bean-curd mill) were only predominant in the rural area.<sup>2</sup> Due to the negative attitude of the leadership towards small scale enterprises and to the state monopoly over the purchasing and marketing of grain, cotton and oil, many handicrafts mills were merged, and the "four kinds of mills" were forced to cease operation.<sup>3</sup>

China began to enunciate a small-scale industry development policy after the people's communes were set up throughout the country in 1958. In addition, decentralization of industrial administration and control functions took place in 1957 and 1958. Small industrial activities throughout the countryside developed very rapidly. By the end of 1958, the labour force in commune-run enterprises reached 18 million and the gross output value of these enterprises was over 6,000 million yuan.<sup>4</sup>

However, during this period, in order to develop commune-run enterprises, the property of the agricultural producers' cooperatives and their members was requisitioned without compensation.<sup>5</sup> The government also mistakenly promoted many technological processes for which there were no existing small-scale options. Large quantities of resources were wasted.<sup>6</sup> This kind of "left" activity caused an agricultural crisis. As Carl Riskin wrote: "With overall production down and supplies of both food and basic household consumer goods becoming scarce, it no longer seemed possible to devote so many resources to investment

and non-essential production."<sup>7</sup> In order to correct the mistake of depriving the peasants of their property, a policy of "going bankrupt for repaying debts" was promoted.<sup>8</sup> Therefore, many commune-run enterprises were closed. By 1961, the gross output value of commune-run industry throughout the country had been reduced to 1,980 million yuan.<sup>9</sup>

In 1962, the state stipulated that commune and production brigades were not to set up enterprises. As a result, by 1963, the gross output value of commune run industry had further reduced to 410 million yuan.<sup>10</sup>

In the late 1960s, the "five small industries" (iron and steel, cement, chemical fertilizer, machinery and power) developed very rapidly although these enterprises were run at the level of the county.<sup>11</sup> Meanwhile, the leaders had considered that it was necessary for the communes to run some small factories. Therefore, Commune- and brigade-run industries began to develop again.

During the Cultural Revolution, China had adopted the Dazhai Production Brigade in Xiyang County, Shanxi Province as a model to develop agriculture. Some practices of ultra-leftism prevailed. Private plots and domestic sideline occupations of the commune members were all eliminated as "tails of capitalism". Commune- and brigade run industries and sideline occupations were restricted and diversified undertakings strangled. Village fairs were banned. Economic exchange between town and country was stopped.<sup>12</sup> These



ultra-left practices associated with the Dazhai Model were promoted across the country, causing great damage to China's agriculture as well as the development of rural enterprises. However, as Qi Zong indicated: "...these enterprises had a strong appeal and inspired a great vitality among the people, so they continued to develop despite these obstacles."<sup>13</sup> In 1976, the gross output value of commune- and brigade- run industries reached over 24,300 million yuan.<sup>14</sup>

Therefore, it is clear that rural enterprises had expanded before 1978, though almost entirely in the collective sector of rural industrial enterprises. The policy towards rural enterprises before 1978, mainly rural industries, justified its contribution to "self-reliance" and "walking on two legs"<sup>15</sup>.<sup>16</sup>

However, Western observers argued that the realities for the development of rural small scale industrial enterprises were that China's rural economy was too poor to overcome the isolation of the countryside from the industrial mainstream, but adequate to build small-scale industries. In addition, industrial goods were difficult to obtain because of poor transportation and the long waiting list for industrial items.<sup>17</sup>

In addition, rural small scale industries had characteristics that suited the technological and economic constraints of rural economy. Small plants could be built faster than modern large-scale enterprises, and transform



locally available raw materials into useful products.<sup>18</sup> Small-scale factories were located close to their markets. By designing goods for local conditions, rural enterprises were able to compensate somewhat for the low quality of the available materials.<sup>19</sup> They had other advantages that partly offset their inefficiency relative to large-scale firms. They required less infrastructure and expenditures on housing and public utilities.<sup>20</sup> They could also offer significant social benefits, including the improvement of the mechanical aptitude and industrial discipline of the peasantry, and the narrowing of the gap between rural and urban incomes and living standards.<sup>21</sup>

Jack Gray summarized that the main economic and ideological arguments to support the development of rural enterprises before 1978 in China were as follows:

Rural enterprises could make use of scattered raw materials, and could make use of surplus labour in rural areas and diminish unemployment. Rural enterprises could mobilize rural savings, and could provide a local flow of consumer goods. The flow of consumer goods could maintain incentives among the peasants. The profit of rural enterprises could be invested for further growth of rural economy. There was a growing need for small factories for short-run production of spare parts, accessories, and goods suitable for local conditions.<sup>22</sup>

As far as ideological factors were concerned, Mao thought that rural industry could provide the quickest route

to socialism and the creation of new socialist man by maximizing participation in co-operative enterprises. The industrialization of the rural areas could gradually eliminate the distinctions between industry and agriculture, mental and manual labour, and city and countryside. The development of local communities via self-reliant industrialization, and the transformation of agriculture would both minimize the need for bureaucracy and at the same time create a countervailing power.<sup>23</sup> Mao was also concerned with national defence. He wanted to ensure that production of dispersed small industries could continue even after the perceived threat of military attack from abroad receded.<sup>24</sup>

However, there were the following limitations of policy towards the development of rural enterprise before 1978.

First the attitude of China's leadership towards rural enterprises was to overlook them and to stress their role as the complementarity of agriculture and urban industry. This included two different aspects. On the one hand, rural industry only served as a complement to the modern industrial sector, but on the other hand, rural enterprises also served as a complement to agriculture.

Second the market was underdeveloped. It was almost impossible for rural enterprises to buy raw materials in the market. Jon Sigurdson has estimated that, because of constraints on both market and resource expansion, at least

two of the "five small industries"--iron and steel, and chemical fertilizers had by 1973 almost exhausted the opportunities for further expansion throughout the country.<sup>25</sup> Planners were more sophisticated over time. During the Great Leap, the government mistakenly promoted many technological processes for which there were no existing small-scale options. As a result, large quantities of resources were wasted before new varieties of small plants were designed and produced.

Third, before 1978 China had very strict constraints on farmers engaging in non-agricultural occupations. Under the influence of 'leftist' ideology for many years, the policy of "grasping grain as the key link" confined a large number of peasants to working a small area of arable land. It condemned "businessmen" as people "not engaged in honest work" or even as people "taking the capitalist road".

Fourth, China did not then allow the development of rural enterprises in the private sector. This will be analyzed in the next section. This also limited the development of rural enterprises.

Fifth, before 1978 China had not implemented the open door policy. Thus, it was impossible to develop export-oriented rural enterprises.



### **2.1.2 Policy Towards Collective Rural Enterprises After 1978**

The Maoist version of the centrally planned economy had failed to produce efficient economic growth and had caused China to fall far behind not only the industrialized nations of the West but also the new industrial powers of Asia: Japan, the Republic of Korea, Singapore, Taiwan, and Hong Kong. In the late 1970s, China's citizens did not have sufficient food and clothing, adequate housing and service sector. Therefore, China's leaders realized that if the Party was to retain its position and the country was not to slide further behind its competitors in terms of economic development, policy changes must take place.

In the historic Third Plenary Session of the Eleventh Central Committee of the CCP in December 1978, the party leaders decided to undertake gradual but fundamental economic reforms. China's economic reforms can be distinguished from other reformers like the former Soviet Union and India in two main ways: the open door policy and rural reform policy. The open door policy has provided more opportunities for rural enterprises in China's coastal areas, to gain access to international markets. However, its impact for China's rural enterprises is marginal. The most significant impacts of policy changes for rural enterprises came from rural reform.



The first step in reforming the rural sector was the introduction of the household production responsibility system. Under this system, the cooperative assigned specific plots of land to a family to cultivate for up to fifteen years. For each piece of land, the cooperatives specified the quantity of output that had to be delivered to procurement stations. Any surplus was for the household to dispose of as it saw fit. Families could consume the surplus or sell it on rural markets as they wished. As a result, agricultural output increased rapidly, creating a solid base for the development of rural enterprises.

Second, households with insufficient labour were able to transfer land contracts to families that were interested in cultivation and animal husbandry. Peasants were permitted to shift from crop cultivation to commercial, service, construction, and industrial activities in rural enterprises. The government has removed the constraints against farmers engaging in non-agricultural occupations, and has allowed a large number of rural people to go into non-agricultural occupations. These reforms have facilitated the supply of surplus labour for rural enterprises.

Third, rural markets were reopened. The rural marketing system changed substantially. Households with marketable surplus had several options: goods could be consumed, sold in local markets, or sold to state stations according to signed purchase contracts. The government raised procurement prices to improve incentives and reduced farmers'

agricultural taxes. These rural reforms have generated the rural savings necessary to develop rural enterprises.

Fourth, reform policies also reduced major administrative barriers that had limited labour and capital from moving beyond commune boundaries. Capital in rural areas was permitted to move across administrative boundaries, and individuals invested not only in their own farm production but also in business ventures outside their own villages. In particular, rural enterprises have been allowed to be established in small towns. These policy changes have provided rural enterprises more chances to be concentrated on small towns and to cooperate with state enterprises.

Since 1978, the Chinese government has attached great importance to the development of rural enterprises, regarding their development not only as an important facet of readjusting the rural economic structure and a strategic measure to vitalize China's rural economy, but also as the road to the integration of urban and rural areas.<sup>26</sup>

In December 1978, the CCP's 11th Central Committee emphasized at its third plenary session the need to develop commune- and brigade-run enterprises. The Third Plenary Session of the 11th Central Committee of the Communist Party of China pointed out in its "Decisions on Some Questions Concerning the Acceleration of Agricultural Development":

"under the principles of reason and economy,  
all agricultural and sideline products well-suited

to being processed in rural areas should be increasingly produced by commune- and brigade- run enterprises. Factories in the cities should, in a planned way, turn over those products or parts which can be processed in rural areas for processing by the commune- and brigade- run enterprises, as well as lend support in equipment and guidance in technology."<sup>27</sup>

Therefore, China's leaders decided that urban enterprises could hand over to commune- and brigade-run enterprises the production of those commodities where processing was suitable in rural areas. As we can see, although this policy change facilitated the expansion of the operations of existing rural enterprises, the CCP was not yet prepared to legitimate the expansion of the non-state sector. At this stage, the notion that the communes (and brigades) should control affairs remained firm.

In 1980, the campaign to reorganize rural enterprises was launched. Certain enterprises were closed, suspended, merged or transferred. Their number was reduced from 1,480,000 in 1979 to 1,430,000 in 1980, but their total income and profits were higher than those of the previous year.<sup>28</sup>

After the household production responsibility system was successfully implemented in agriculture, China's leaders decided to introduce the contracts system into commune-run and brigade-run enterprises. In March 1983, a *People's Daily*



commentator<sup>29</sup> called for local government to introduce the contracts system into commune-run and brigade-run enterprises after he summarized the experiences of the Shangquiao Commune in Xuancheng county, Anhui province. He argued that the contracts system had enhanced the rationalization of the structure of business management and had changed the situation of stagnation in development; this system had been described as orientating the direction of management toward serving the society and market demand. He also thought that this system had systematized enterprise management, and combined responsibilities, power and profits so that enterprises had power to make management decisions. The implementation of the contract system has aroused the enthusiasm of the workers in production, has thus improved the management of rural enterprises. I will further discuss this issue in section 7.1 of Chapter Seven.

1984 was a very important year for rural enterprises. The CCP Central Committee and the State Council issued a circular to transmit a "Report on creating a new situation in commune and brigade enterprises" by the Ministry of Agriculture, Animal Husbandry, and the leading Party Group of the Ministry in March, 1984.<sup>30</sup> It argued that China should use diversification as the strategic principle to utilize surplus labour in rural areas so that China could change the situation of having 800 million people producing food and gradually accumulate the large amounts of funds needed to modernize agriculture. In this report, village



and town enterprises were considered as an important component of a diversified economy, an important pillar of agricultural production, an important way for the masses of peasants to achieve common prosperity, and an important source of state revenue.

In addition, in this report, the development of village and town enterprises was described as being conducive to expanding agricultural capital construction, increasing the strength of the agricultural co-operative economic organization and providing more and better agricultural machinery and services for peasants. This report argued that the development of village and township enterprises can promote the system of contracting specialized jobs and suitably expanding their scale of operations. Their development can also promote the growth of the market towns, accelerate the construction of economic and cultural centres in the countryside, and prevent peasants who give up farming from leaving the countryside, and deter the massive influx of peasants into the cities. Furthermore, in this report, village and town enterprises were regarded as an important force in the national economy and an important supplement to state-owned enterprises.

This report is the most important official document concerning rural enterprises published in the 1980s. It can be seen that China's leaders have realized the important roles of rural enterprises in the development of agriculture, solving rural unemployment and the national

economy. This report also regarded individual rural enterprises as a part of village and town enterprises, and gave a permit for further development. As a result, this has provided a base for the development of private enterprises. Moreover, this report called for party committees and governments at various levels to give village and town enterprises "positive guidance" and "necessary support". However, in this report, rural enterprises were still asked to play a supplementary role to agriculture and state-owned enterprises. At this stage, China's leaders did not realize that rural enterprises would become a serious challenge for state enterprises in the late 1980s.

The CCP Central Committee also supported the development of town and township enterprises in its Document No. 1 and 4 in 1984. It provided policy guidance concerning credit extension and taxation of township and town enterprises in its Document No. 1, 1985.<sup>31</sup> In its Document No.1, 1986, it claimed that the development of township and town enterprises was of great economic and political significance and urged various departments to adopt supportive measures.<sup>32</sup> The above discussion provides evidence of the gradual introduction of new policies and measures to promote the development of rural enterprises. It also shows that the central government was aware of the importance of the development of rural enterprises given its wider commitment to agricultural reform. However, it is important to note that at this stage, developing the private sector of rural

enterprises was not considered to be a viable option. Indeed, the legalisation of private rural enterprises - the first step in their development - did not occur until as late as 1988.

Economists in China have also regarded the emergence and development of township and town enterprises in rural areas as an objective necessity. They believe that to practice a planned commodity economy on the basis of public ownership and to promote socialist commodity production and socialist commodity exchanges, the development of township and town enterprises is inevitable.<sup>33</sup> The second stage in China's rural reform must continue the policies of liberation and invigoration, promote the development of rural productive forces, help the countryside transform itself from a semi-self-sufficient natural economy to a planned commercialized economy, transform traditional agriculture into modernized agriculture and gradually reduce the gaps between industry and agriculture and between city and countryside so that the national economy can develop rapidly and in a balanced fashion. The key to the second stage in rural reform is the vigorous development of township and town enterprises.<sup>34</sup> The main arguments for the necessity of the development of rural enterprise are as follows:<sup>35</sup>

First, the financial resources of the state are limited and it would be unrealistic to expect the state to provide more funds to subsidize agricultural modernization. China



has to make new breakthroughs in agriculture, it must introduce new inputs, maintaining and expanding farmland irrigation and drainage systems, promoting greater agricultural mechanization, increasing inputs of quality chemical fertilizers and pesticides and applying and disseminating science and technology, such as developing and spreading improved crop strains. These will require a tremendous amount of funds. The state proposed a general policy, "use industry to subsidize agriculture". This "industry" is none other than rural enterprises. With the development of rural enterprises, China can use the profits generated by these enterprises to provide financial assistance to agriculture so as to enable the agricultural sector to continue to develop.

Secondly, the development of rural enterprises can not only support the prosperity of the rural economy, change and reform rural economic structure, but also, push the development, change, and reform of the national economy, and influence the future of China's economy. On the side of the growth in the economy, rural enterprises can make prominent contributions, manifested in the increase of gross output value, national financial revenues and foreign exchange earnings. The development of rural enterprises can also make contributions to both market supply and market expansion and promote changes in the economic structure at a comparatively fast rate.



Thirdly, in order to achieve rural specialization, China must change the situation in which the majority of people engage in agriculture, and the only way to do this is to transfer peasants into non-agricultural employment. It is impossible to accomplish this if China depends on state-sponsored secondary and tertiary industry to absorb all surplus rural labour. Thus the way is to let peasants raise their own funds, take full responsibility for their own profits and losses, set up various township and town enterprise on their own and transform themselves into enterprise employees. Furthermore, the development of rural enterprises can restructure the irrational mix in China's rural output by developing rural secondary and tertiary industry.

Fourthly, in order to commercialize the countryside and to develop a commercial economy, China must ensure great abundance of various commodities. It is impossible to produce commodities if over 800 million peasants continue to engage in agriculture. Moreover, China's commercial, communications, storage and shipping and service sectors are too backward and fall far behind the levels attained in China's primary and secondary industries. Thus the mobilization and encouragement of rural enterprises to engage in commercial, transport, service and other industries comprise another important link in the reform of the commercial system.

Compared with China's government policies towards collective rural enterprises before 1978, the government took direct measures to promote collective rural enterprises. Some reform measures to promote management and technology have taken place in the collective sector of rural enterprises. The main reform measures are as follows: First, the 'production responsibility system' and new contractual arrangements were introduced in rural enterprises; Secondly, the labour recruitment system has been changed; Thirdly, a new income distribution system has been introduced; Fourthly, the central government adopted some policies to promote product quality in rural enterprises; Fifthly, the "Spark Plan" promoting the technological level in rural enterprises has been implemented; Sixthly the central government adopted a more flexible policy to allow technological personnel to work in rural enterprises; Seventhly, the central government has taken some measures to promote technological cooperation between rural enterprises and state enterprises and between rural enterprises and research institutes. These government policies and measures have had profound impacts on the development of rural enterprises, which I will further analyze in Chapter Seven and Chapter Eight.

Furthermore, the state has extended decision making powers to local governments, enterprises and individuals. Local governments have been allowed to adopt different models to develop rural enterprises. I will further deal

with this issue in Chapter Three. Since 1978, China has also engaged in market reform. There has been a considerable development of the market. The reform of the market has made a noteworthy contribution to the development of rural enterprises since 1978. I will analyze their implications in Chapter Four. In addition, the government has changed rural employment and regional development strategies, and has also encouraged the development of rural enterprise by providing favourable tax and financial policies and offering rural enterprises lucrative investment opportunities. I will examine these issues in Chapter Five and Six.

While central government policy encouraged rural enterprises to coordinate with state enterprises and promote joint ventures during 1980s, it did not encourage activities that competed with state enterprises for energy and raw materials in short supply. That is, rural enterprises were expected to exploit locally available resources and not to increase the use of scarce national resources.

During the early 1980s, rural enterprises played the role of making up for the deficiencies of large enterprises rather than competing with them. However, in the late 1980s, this relation changed, and rural enterprises began to compete with state enterprises for the supply of raw materials. The state's attitude has been to ensure the supply of raw materials to state enterprise, and to allow the remaining or newly increased raw materials to be



processed by rural enterprises after state procurement quotas are met.

However, rural enterprises have more decision making power in production and management. They can choose from a variety of flexible management methods according to market needs, arrange in a planned manner their own production, supply, and marketing activities, and budget funds retained for their own use.<sup>36</sup> Rural enterprises have other advantages which state-run enterprises lack: they have an ample supply of cheap labour, and the problem of enterprises sites is comparatively easy to solve. The other is that they have full decision making power. Rural enterprises have many more rights of autonomous decision making. They are responsible for their profits or losses, and are capable of absorbing technological results in breadth from units of scientific research and institutes of higher education in the form of transfer with compensation. Therefore, rural enterprises are more competitive than state enterprises.

In late 1988, overheating of the economy, inflation, widening income differential, and corruption took place in China. This led to a period of economic austerity. Faced with an economic crisis and resistance from the conservative forces, rural enterprises became a main target of the economic austerity program. From late 1988 to 1991, the government emphasized the key function to be played by state-run large and medium-sized enterprises and adopted a policy where state enterprises were definitely favoured in



the acquisition of the capital, energy, and raw materials. Rural enterprises faced a serious situation: capital funds were scarce, energy sources were insufficient, prices for raw materials went up, and the scope of market shrunk.

In addition, some departments in local governments used the excuse of improvement and rectification to indiscriminately collect fees, and impose fines on enterprises, seriously infringing their legitimate rights and interests and placing an unbearable burden on them.<sup>37</sup> As a result, during this period, rural enterprises faced serious difficulties under the austerity programme. Many rural enterprises were closed, merged with others or shifted to other businesses; many employees in rural enterprises had to return to the land.

Local governments put great pressure on the central government. Some economists also made strong protests against the central government policy of discriminating against rural enterprises. For example, Yu Guoyao and Yi Yandong wrote that it would not make sense to force the growth rate of the township and town enterprises below that of urban industry.<sup>38</sup> Su Bei also indicated: "We have to make a clear distinction: adjusting is not negating. Adjustments want to achieve a steadier advance and a healthier development for township enterprises."<sup>39</sup>

Moreover, some rural enterprises have already forged business links with urban industries. These links have been widespread in machine-building and among newly opened

enterprises. For example, in 1989, in Zhenjiang city, Jiangsu Province, of the 4.7 billion yuan of industrial output value, roughly 2 billion yuan came from rural enterprises which had varying degree of economic ties with urban industries. 30 percent of township and town industries had close ties with urban counterparts.<sup>40</sup> Many rural enterprises have become workshops of urban industrial enterprises. This type of business connection has made rural enterprises into an indivisible part of urban industry. Attempting to pressure rural enterprises to preserve state industries will also affect the growth of the national economy.

In late 1991, the political and economic situation was changed again. Some reform measures have taken place. "Decision of the CCP Central Committee on Further Strengthening Agriculture and the Work in Rural Areas", adopted by the eighth plenary session of the 13th CCP Central Committee on 29th November 1991, indicated actively developing township and town enterprises is a way to develop rural economy, to increase peasant's income, and to speed up agricultural modernization and national economic development. This document called for carrying through the principle of giving active support to township and town enterprises, making plans for the reasonable development of these enterprises, providing correct guidance to them, and strengthening management of them.<sup>41</sup>

In addition, important remarks made by Deng Xiaoping during a tour to the south of China, and the Fifth Session of the Seventh National People's Congress have both certainly promoted further economic reform in early 1992. Some important policies have been formulated to encourage the development of rural enterprises. The State Council also issued a package of new policies to prop up rural enterprises, particularly in inland areas in early 1992.<sup>42</sup> These measures are summarized as follows:

First, local governments have been asked to set up development funds for rural industries, which usually get little investment from the State budget. State run banks will increase loans to help successful rural firms with technological innovations. Key rural enterprises will be given aid in term of credit, taxes, energy, raw materials, transportation and the employment of technologists. Secondly, the government has taken further measures to promote technology in rural enterprises. The government will allow successful rural enterprises to increase their depreciation rates in order to update facilities; and their key projects for improving technology should be listed in local economic plans. More college students will be encouraged to work in rural enterprises. Thirdly, the government has adopted the measures to expand the scope of businesses for rural enterprises. Certain rural enterprises will be granted rights to deal in foreign trade. The government will no longer prevent rural firms from engaging



in wholesale and retail enterprises. Service industry will open a wide door for rural enterprises. Fourthly, the government has undertaken the measures to reduce financial burdens on rural enterprises. Rural enterprises will be permitted to retain at least 60 percent of after tax profits. Poor areas will be given more help to develop rural enterprises.

New policies for rural enterprises showed that the government will continue to provide favourable financial, technological and management policies to promote the development of rural enterprises, and create more business opportunities for rural enterprises. In particular, the new policies have paid more attention to the development of rural enterprises in poor rural areas.

Official statistics show that China's rural industries increased production by 36.1 percent in the first quarter of 1992 compared with the same period of 1991.<sup>43</sup> Therefore, the development of rural enterprises is expected to speed up again.

In summary, the central government has relaxed restrictions on the large-scale expansion of non-agricultural activities by rural communities. Furthermore, the government has formulated some policies to encourage the development of collective rural enterprises since 1978.

## 2.2 Policy towards Individual and Private Enterprises

Since 1978 there has been a dramatic change in policy in the People's Republic of China which has again allowed the establishment of individual and private enterprises. Previously China had eliminated private enterprises in the traditional capitalistic sense, leaving only handicrafts as a supplementary sideline. Now both "private enterprises" and "individual enterprises" exist. The term "private enterprises" refers to those whose means of production are privately owned and with eight or more employees,<sup>44</sup> as compared with the category of "individual enterprises" meaning businesses started with private funds employing seven or less. The essential difference between the two in the Chinese thinking is that the latter is categorized as being owned by the labouring people because the owners still thrive mainly on their own work, while the former is traditionally considered "capitalist ownership" because owners depend mainly on the employment of wage earners. Since the majority of individual and private enterprises are in rural areas, the government policy towards individual and private enterprises have important impacts on the development of rural enterprises. Thus, in this section, first I will give a brief review of the policy towards individual and private enterprises before 1978. Then I will examine the government policy towards individual

enterprises since 1978. Finally, I will analyze the government policy towards private enterprises.

### **2.2.1 A Brief Review of China's Policy towards Individual and Private Enterprises Before 1978**

The development of the private economy in China can be divided into the following periods before 1978.<sup>45</sup>

The first stage lasted from 1949 to 1953. During this period, the government allowed different sectors of the economy to coexist with the state-run sector in the leading position. Individual businesses and private capitalist businesses were developed along with the recovery of the country's economy. There were 7.24 million individual industrialists and businessmen in the country's cities and towns in 1949. By 1953, the number had increased to 8.38 million.<sup>46</sup>

The second period was from 1953 to 1956. In 1953, China stated to engage in the socialist industrialization and socialist transformation of agriculture, handicrafts, and capitalist industry and commerce. By the end of 1956, 95 percent of small trades people joined cooperative shops, cooperative groups, or took part in joint public-private and state-run enterprises; meanwhile, 96 percent of individual industrial and commercial people joined handicraft production cooperatives or cooperative groups.<sup>47</sup> The transformation left only about a hundred thousand



individuals in industry and commerce who had not joined any cooperative.

The third period was from 1957 to 1965. The policy toward the remaining individual industry and commerce in this period can be summarized as utilizing, restricting and transforming. A 14-grade taxation system based on progressive rates was introduced which taxed the individual businesses heavily, the highest tax rate being 86.8 percent.<sup>48</sup> The income of the individual business people was strictly held at a level which just maintained a simple life. Soon after the transformation of the private sector, underground factories came into being in some places. Mao admitted that the resurgence of underground factories meant there was a social need for them. Therefore husband-wife shops and privately-run factories were given permission to operate. Chen Yun declared at the Eighth National Party Congress that, while the state and collective economy were dominant, it was still necessary to have a certain number of individual businesses to supplement the state and collective sectors. This made it possible for individual enterprises in industry and commerce to recover to some extent. However, there then came the nationwide campaign of setting up people's communes and the so-called socialist transformation of individual industry and commerce was again intensified. Not only those who had joined cooperatives had to advance to ownership by the whole people, but those remaining

individual also had to be transformed. The number of individual businesses again plummeted.<sup>49</sup>

The ten years of the Cultural Revolution from 1966 to 1976 comprised most of the fourth stage which actually lasted until 1978. During the Cultural Revolution, individual economy was considered capitalistic and was practically eliminated. Most individual industry and commerce were banned or merged. In the rural areas small plots of land allocated to the commune members for private use and household sideline production were also repeatedly eliminated as "tails of capitalism". The results were that state and collective industry and commerce monopolized everything. By 1978, only 140,000 people were in individually owned undertakings throughout the vast country of China, and they were mostly small retailers and repairers.<sup>50</sup> In summary, China's policy towards private enterprises during 1949 to 1978 changed from tolerance to elimination.

### 2.2.2 Policy towards Individual Enterprises Since 1978

In 1979, the state decided to restore and develop individual industry and commerce. The authorities thought that individual enterprises were different from private enterprises, in which the private ownership of the means of production is combined with hired labour and the capitalists make a profit through exploiting the labourers. Under socialism, individual industry and commerce are considered a supplement to socialist industry and commerce. In 1980, at a national work conference on employment, the central authorities pointed out more clearly that it is necessary to develop the individual economy to a proper degree. After that, the state formulated a series of policies to encourage peasants and urban residents to develop tertiary industry. Retired workers were allowed to operate individual shops. Some small shops were leased or contracted for individual operation.<sup>51</sup>

The 1982 Constitution stipulated that: "The individual economy of urban and rural working people, operated within the limits prescribed by law, is a complement to the socialist public economy. The state protects the lawful rights and interests of the individual economy".<sup>52</sup> Thus, individual enterprises in China were accorded legal status again. This is not only important for the development of individual enterprises, but was also conducive to the



subsequent development of private enterprises. When individual enterprises were allowed to develop, many of them employed more than eight employees. In the process, the delineation between "individual" and "private" became somewhat blurred - indeed, many of these "individual enterprises" formally became "private enterprises" after their legalization in 1988. Thus, without formally tackling the question of whether private enterprises should be allowed to exist and develop, the changes in the 1982 constitution facilitated the subsequent move towards official and legal acceptance of privately owned rural enterprises. As such, the new constitution marks an important watershed in the removal of the restrictions that hindered the development of rural enterprises in post-Mao China.

In February 1984, the State Council issued some regulations governing individual industry and commerce in rural areas in order to strengthen further the leadership, management and supervision over individual industry and commerce in rural areas.<sup>53</sup> The regulations stated that the development of individual industry and commerce in rural areas would play a positive role in promoting commodity production in rural areas, stimulating exchanges of materials between urban and rural areas and putting surplus rural labour to multiple use. Therefore, the government tried to strength its leadership over rural individual enterprises, and also expected rural individual enterprises

to play a greater role in rural economic development and solving the problem of rural unemployment.

In China, individual enterprises mainly involves small industries, the handicraft industry, the transport industry, the construction and house maintenance industry, commerce, the catering trade, and other service trades. The number of individual businessmen reached 18 million in 1987, but three-fourths of them were in rural areas.<sup>54</sup>

In some areas where policies toward the individual economy are carried out more flexibly, the development of the individual economy has greatly exceeded the development of state-owned and collective enterprises. Individual business operators do business with small capital. In order to survive, they have to pay attention to their business goodwill and service quality. The existence of individual businesses is itself a forceful challenge against egalitarian practice.

However, under the influence of "Leftist" ideology and policies, a few people in society still hold a prejudice against individual business operators because some individual businessmen evaded taxes and often practiced fraud and did not observe trade ethics there by harming the consumer's interests.

Although the government laid down policies for encouraging the development of the individual economy, individual business operators still feel that their status is low and they are still despised in society and have no

bright future. Thus, they want only to make big money in a short time by making use of the opportunities brought about by government policies rather than doing business in an honest manner throughout their lives as individual operators.

State policies toward the individual economy have been unstable, and this has placed obvious pressure on individual business operators. In January 1986 the State Council promulgated its Provisional Regulations Regarding the Income Tax of Individually Owned Industrial and Commercial Establishments in Town and Country, which implemented a ten-bracket progressive income tax aimed to bring under control the high earning of individual businesses.<sup>55</sup> After paying taxes and administrative fees, individual business operators often have to pay many kinds of mandatory fees and contributions in the names of "sponsoring" or "raising funds". Although some problems still remain, the state's policies towards individual enterprises have been more liberal.

### **2.2.3 Policy towards Private Enterprise Since 1978**

The first new private enterprises in China emerged in the early 1980s with the beginning of economic and political reforms. Most private enterprises were distributed in the suburban areas of the smaller cities and large towns.<sup>56</sup> More than 80 per cent of private enterprises were based in



the countryside. More than 70 per cent of these private enterprises were operating in more developed rural areas along the coast.<sup>57</sup> Most people working with the newly formed private enterprises were the surplus labour force in the wake of reforms in the rural economic structure.

A private economy used to be regarded as incompatible with the socialist system in China. According to Marxist-Leninist doctrines, ownership of all means of production in socialist countries should be vested in the State. Before 1988 private economy did not have a definite legal position in China. This can be seen in Article 5 of the 1978 constitution of the People's Republic of China:

"There are mainly two kinds of ownership of means of production in the People's Republic of China at the present stage: socialist ownership by the whole people and socialist collective ownership by the working people."<sup>58</sup>

"Ownership by the whole people" denotes means of production owned by the State; and "collective ownership by the working people" denotes means of production owned by worker or farmer cooperatives.

Public opinion is, accordingly, divided on the treatment of private enterprises since they are traditionally considered "capitalist". The most common complaint against the private economy is that entrepreneurs exploit their workers and create forms of labour-capital relations which are incompatible with the Chinese socialist

system. It is concluded that the private sector of the economy has distorted the economy and destroyed the national plan since some private enterprises engage in speculation, price boosting, illicit purchase of raw materials, bribery and corruption involving government cadres and use underhand methods to obtain services from workers in government departments and state owned enterprises. There is also a concern in some areas that the development of private enterprises may lead to the development of social stratification; the rich becoming richer and the poor becoming poorer. Thus, it was suggested that the government should adopt a combination of administration and economic measures to tighten control over the development of private enterprises.<sup>59</sup>

Others who supported the development of the private economy held that it differed in nature from that which existed in the 1950s except for the private employment of workers. The private economy in the 1950s was a 'national capitalist',<sup>60</sup> economy and signified the indigenous development of capitalism in China. In contrast, the current private economy serves as a supplement to the state and collectively owned economies. Nowadays the private economy is not strong enough to determine the nature of China's society. Its supporters stress its positive role in promoting the productive forces. They believe that China is now in the primary stage of socialism<sup>61</sup> which is characterized by backward productive forces, reflecting the

low degree of industrialization and underdevelopment of the market economy. In particular, the per capita gross national product in China still ranks among the lowest in the world. Therefore, China must focus on developing productive forces.<sup>62</sup> Since private economy can promote production, it should be encouraged. Moreover, it is argued that the policy to encourage the development of the private economy does not necessarily lead to extremes of wealth. Although it allows some people to improve their living standard before others, its ultimate objective is to achieve general prosperity more quickly.

Although the Chinese Government officially believes that private enterprises inevitably lead to the exploitation of labourers, a moderate development of this sector is considered positive in promoting production, providing employment, making people's life more comfortable and increasing state revenues. The authorities have for some time adopted ambiguous attitude, while they have not taken the strong measures to prohibit the development of private enterprises.

At the 13th Communist Party Congress in October 1987, former Party General Secretary Zhao Ziyang set an authoritative tone on the controversial subject of private enterprises. In his report, Zhao explained why it should be allowed to develop in China. He stressed that

"Public ownership should remain predominant in the primary stage of socialism. However, other



sectors of the economy not under the ownership of the whole people are far from adequately developed. The cooperative, individual, and private sectors of the economy in both urban and rural areas should be encouraged to expand." <sup>63</sup>

Zhao also expected the government to "formulate policies and enact laws governing the private sector as soon as possible, in order to protect its legitimate interests and to provide it with more effective guidance, supervision and control."<sup>64</sup> It was the first time that the "private sector" of the economy formed by private enterprises, had been named in an openly-published party document as something positive. In adopting an ideological stance that formally accepted that private enterprise had a legitimate and even progressive role to play within a socialist society, Zhao laid the foundations for the legalisation of private rural-enterprises the following year. As such, Zhao's speech marks a crucial sea-change in the ideological orientation of China's economic affairs - even if it was only making *de jure* what had been the *de facto* situation since the decision was taken to expand "individual" enterprises in the revision of the 1982 constitution.

Subsequently, at the 7th National People's Congress in April 1988, an amendment on the private economy was added to Article 11 of the Constitution.

"The State permits privately owned economic entities to exist and develop within the limits

prescribed by the law. The private economy is a complement to the socialist public economy. The State protects the legitimate rights and interests of the private economy while providing the private sector with guidance, supervision and administrative regulation."<sup>65</sup>

For the first time, private enterprises were, in principle, accorded legal status in China.

However, until then there had not been any significant elaboration of law or regulation for private enterprises.<sup>66</sup> Lack of laws and regulations had caused problems and hampered further development of private enterprises. Some entrepreneurs feared that the government would change its current policy of encouraging private enterprise. Some private firms had been found to engage in unlicensed dealing or tax evasion, to lack safety facilities or demand long working hours under poor working conditions. For example, an investigation by the Beijing Municipal People's Government in 1987 revealed that some employers did not have any medical insurance, and more than 80 per cent of employees did not enjoy any kind of medical welfare.<sup>67</sup> On the other hand, there had also been cases of infringement upon the legitimate rights of private enterprises. In many cases, private enterprises had been confronted with excessive tax demands or had experienced difficulty obtaining permits to establish their enterprises. For example, one private entrepreneur said he had to treat the person in charge of

issuing the business permits to a dinner in a luxury restaurant before he got his permit to open a restaurant.<sup>68</sup> Thus, it was in the interest of both the government and private enterprises to stipulate clearly the scope of regulation on private enterprises.

Shortly after the 7th National People's Congress in June 1988, the State Council issued the "provisional regulations on private economy" and the "provisional regulations on income tax of private enterprises". They are the country's first two regulations on operation, management and income taxation for private enterprises.

Although the State has done much to protect the development of private enterprises to date, there is still some discrimination against them in access to loans, tax relief and supplies of materials in short supply. Shanxi provincial government made an investigation of 54 private enterprises. It revealed that these enterprises did not receive the same treatment from the authorities as the collectively owned enterprises. For example, they could not get enough raw materials and fuels, which they therefore had to buy at higher prices from the free market. The monthly interest rates on loans to state-run enterprise were also much lower than to private enterprises.

Since some people in power still tend to believe that private institutions deviate from socialist ideals and should not be encouraged, some government departments tend to "give special treatment to the collectives, slight the



cooperatives, and to squeeze out the individual businesses."<sup>69</sup> Many state enterprises are unwilling to establish business relations with private entrepreneurs. The scope for private enterprises in general is officially restricted. For example, the regulations forbid private enterprise from engaging in the military industry and banking business, and from dealing in specified goods under State protection and monopoly such as cultural relics, jewellery, automobiles and civilian explosives.

Even amongst those in the CCP leadership who favour the existence of private enterprises, there is a belief that private enterprises should not be allowed unrestricted expansion even if it differs greatly from capitalism in capitalist societies. It has to be subordinated to the dominance of public ownership and subject to the guidance and restrictions of state policies as well as government decrees and regulations on taxation and loans.

In short, although private enterprises have acquired a legal status, they still face many difficulties and different forms of discrimination.

### **2.3 Conclusion**

It is now clear that distinct policy changes for rural enterprises have taken place since 1978. Before 1978, China's policy concerning rural enterprises had very much emphasized the development of commune- and brigade-run

enterprises, in particular, agricultural product processing enterprises. China's leaders overlooked them and only demanded them to complement agriculture and state enterprises. Furthermore, the market was then underdeveloped. In particular, the government had tight constraints on farmers engaging in non-agricultural occupations, and prohibited the development of individual and private enterprises.

Since 1978 the most significant policy changes towards rural enterprises appear to be as follows: First, policy changes permitted peasants to engage in nonagricultural activities. In general, the central government provided a policy that encouraged the development of collective rural enterprises. Second, the Chinese government has legalized both individual and private enterprises. The private sector of rural enterprises has been tolerated. These changes of policy have done much to promote the development of rural enterprises.

However, it must also be recognized that although private enterprises have acquired a legal status, in particular, private enterprises still face many difficulties and different forms of discrimination. Similarly, there is still considerable discrimination against rural enterprises whether they are collective-run or private-run enterprises such as in the supply of raw materials and credits, compared with the policy towards state-run enterprises. Moreover, the policy changes have been inadequate. Some political and

ideological problems have still remained an obstacle restraining rural enterprises to make an even greater development. I will discussed these problems in the following chapters, especially in Chapter Nine.

In this chapter, I have discussed the evolution of China's central government policies towards rural enterprises. Since China is a big country, different regions have different economic and geographic conditions. Thus, the different regions have adopted the different development strategies of rural enterprises. Therefore, in the next chapter, I will examine local governments' development policies for rural enterprises. Since the focus of the research in the next chapter is to exemplify local government development policies and approaches of rural enterprises, much care is given to the selection of case studies. In the next chapter, the Southern Jiangsu Model and the Wenzhou Model will be selected for analysis.



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### Chapter 3 Regional Policy Variations for Rural Enterprises

The analysis in this thesis is primarily concerned with central government policy towards rural enterprises. As was shown in Chapter Two, numerous central directives and initiatives were issued and undertaken between 1978 and 1992 to sponsor the growth of collective rural enterprises. However, private rural enterprises did not receive the same preferential treatment - indeed their existence was not formally or legally accepted until as late as 1988.

But one of the most striking features of China's economic (and to a lesser extent, political) development in the post-Mao era has been the degree to which provincial and lower level authorities have been allowed flexibility in the implementation of central policy. At certain times in certain policy areas, lower level authorities have actually gone beyond their formal right to exercise flexibility in policy **implementation**, and have taken on the function of actually **making** policy. As such, there have been relatively wide discrepancies between what the centre officially decrees, and what actually happens on the ground.

In this chapter, I will address the issue of the divergence between central policy and local actions in relation to the development of rural enterprises. I will show that despite the plethora of national level

pronouncements on the "correct" path of development, there has been no uniform pattern of policy implementation at a grass roots level. Indeed, the process of defining a "correct" central policy has in many ways been a reactive process - the centre has distilled a national policy through synthesizing (and of course rejecting) disparate elements of local initiative.

Having briefly analyzed the wider question of centre-local relations in the post-Mao era, I will proceed to assess the importance of five key factors in the evolution of differing local policies towards rural enterprises. These are the implications of the changes of the centre-local relations, the conflicting approaches of rival central leaders, variations in the desire of local leaders to adhere to central policy, the economic legacy in determining an area level of economic development, and the importance of unique geographical and historical factors of different areas. The debate within China itself has centred on the different approaches adopted in Wenzhou, Southern Jiangsu, and Nanhai. As there are wide variations in the experience in these three areas, a comparative analysis of their development will provide the case studies for this chapter.



### 3.1 The Implications of the Changes of Centre-local Relations for Rural Enterprises Since 1978

The extent of the change in centre-local relations since 1978 is one of the most striking consequences of the post-Mao reforms. Virtually no area of spatial policy has been left unaffected by reform, and the resolution of the resulting conflicts between both centre and the provinces and between the provinces themselves will be a crucial determinant of the future trajectory of the Chinese reform process. The changes of centre-local relations occurred not only in politics and economy but also in military and ideology. Although these changes have affected all spheres of the centre-local relationship, the following discussion will be confined to those economic and political shifts which impinge on the development of rural enterprises.

An important component of the CCP's attempt to generate economic modernisation was an uneasy mix of partial market reform and administrative decentralization.<sup>1</sup> The impact of the introduction of partial market reform has been very beneficial for rural enterprises in that it has expanded access to markets, funds and raw materials. These issues will be dealt with in more detail in the following chapter.

But as argued in the introduction, a number of restrictions on rural enterprises' activities remain, which

is partly a function of the only partial introduction of market reforms. Indeed, in some respects, the administrative decentralization which has also taken place has made control of rural enterprises more intimate. Local governments' powers to interfere in the working of the local economy have been enhanced. The causes and consequences of this increase in local autonomy warrant closer attention, particularly in relation to local governments' financial obligations and priorities.

One of the key elements here is the result of the combined changes in the fiscal system, and in centre-local revenue sharing arrangements. As Ferdinand<sup>2</sup> and others<sup>3</sup> have demonstrated, these changes gave local authorities an incentive to maximize their local fiscal base. Since both the fiscal responsibilities to the state and the desire to find investment capital placed local authorities at all levels under severe financial strains, many local governments strove to expand their local revenue base, irrespective of national economic needs and goals.<sup>4</sup> In addition, since the agricultural sector has also faced serious financial shortage and needs large funds for modernization, it proved impossible for local governments to generate sufficient revenue from the agricultural sector.

So on the positive side, developing rural enterprises provided an attractive option for many local governments anxious to increase their local revenue base. Initial start-up costs were low, and returns on investment were generated

relatively quickly. As a result, the expansion of rural enterprises in many provinces has developed in a manner and at a rate that deviated from central government plans and expectations. But on the negative side, many local governments exercised an overtight control of their local economies. What the local government gave, the local government could also take away. As a result, while rural enterprises prospered when times were good, they often found their access to funds and raw materials quickly reined in when the economy took a downward turn.

Another important change occurred in the structure of the rural political-administrative system.<sup>5</sup> There are three main components to these reforms. First, the system of city leadership over counties has been changed. After the cultural revolution, the Chinese countryside was basically divided into two - the cities engaged in industry, while their peripheries were engaged in agricultural production. Now, however, the cities are responsible for local agricultural production as well as industry. This change has brought about a closer working relationship between town and countryside. Secondly, the county (*xian*) political-administrative system has been changed. The 1982 Constitution stipulated that a standing committee should be formed in the county people's congress, meaning that all county revolutionary committees were to be replaced by county people's governments. The delegates to the county people's congress were to be elected directly by the voters.



Thirdly, since the introduction of the new Constitution in late 1982, the central government has reformed rural political structures by substituting new townships and village institutions for the commune, production brigade and team and redefined the scope of their authority and controls. Township governments and villages' committees have to be directly elected by villages.

These changes have profound implications for the rural political system as well as on the development of rural enterprises. As the Chinese political economist Wang Huning has commented, "If a candidate wants to be elected, he must show that he can satisfy local interests."<sup>6</sup> In rural areas, achievement in developing rural enterprises has become an important criterion for villagers to judge a candidate for villages' committees and township governments. Moreover, as I will analyze in both section 3.3 of this chapter and in Chapter Seven, local leaders can gain numerous more tangible benefits from the development of rural enterprises.

### **3.2 The Conflicting Approaches of Rival Central Leaders**

Central leaders' attitude to reform comprises an important component of its extent and scope and regional policy variations. On a wider scale, Hsu argues convincingly that economic developments are shaped and constrained by the pervading political climate of the time, "it is primarily the political leaders and their ideology

that determines political practice."<sup>7</sup> Thus, although provincial and local leaders do have considerable leeway in policy implementation, there are limits to their actions set by the goals and priorities of important central leaders. For example, as I have shown in Chapter Two, the acceptance of an individual and private sector of rural industries was dependent on the ideological interpretations of central leaders, and in particular, of Zhao Ziyang.

Despite the extension of local government power in the 1980s, central leaders have by no means lost total control over the provinces. Although they may be prepared to sanction a relatively high degree of provincial "flexibility", the extent of central leaders' intervention in local affairs has been variable. There are perhaps two main elements here. Firstly, if the issue at hand is one which has crucial implications for the ideological orientation of the state - if it challenges or questions basic so-called "socialist principles" - then central leaders are likely to pay close attention to local initiative. Secondly, if there is conflict between leaders at the centre over the direction of the reform process, then they will concern themselves with local affairs either to promote their ideas, or to rubbish those of opponents. For example, central leaders have frequently identified themselves with particular successful local strategies to prove the wisdom of their view. Deng Xiaoping's support for

Zhao Ziyang's agricultural reforms in Sichuan being an important case in point here.

With particular reference to rural enterprises, central leaders' attitudes towards the development of private enterprises in Wenzhou provides a good and relatively well documented example. Wenzhou region in Zhejiang Province was the first place where private enterprises came to dominate the local economy. Policy implementation and development in Wenzhou have a wider significance than just as an example of local variation. In fact, central leaders' attitude towards the Wenzhou experiment sheds light on the extent that central leaders allow the existence of regional policy variations towards the development of rural enterprises. Therefore, it is worthy of analysis.

In the late 1970s, Wenzhou was a poor unnoticed region of China. However, in the middle of the 1980s, the output of private and individual industries rose dramatically. Meanwhile, the proportion of state industry in Wenzhou's total output decreased. Table 3.1 shows how by 1985, private traders' proportion of total social retail sales reached parity with the state sector.



**Table 3.1 Shares of Social Retail Sales of Commodities in the Different Sectors in Wenzhou, 1980-1985**

Year	1980	1981	1982	1983	1984	1985
Social retail sales of commodities (100 million yuan)	8.81	9.57	10.43	11.99	14.60	19.25
State-owned commerce % .....	38.6	36.9	35.2	33	31.6	27.5
Supply and marketing co-ops .....	35.4	34.2	31.1	27.5	23.2	18
Collectively owned commerce in other forms(%) .....	23.9	25.7	26.4	25.4	24.8	27
Individual Businessmen (%)...	2.1	3.2	7.3	14.1	20.4	27.5

Source: Wang Youfen and Li Ning, "Rural Changes promote urban reform", *Beijing Review*, No.43, October, 1986.

According to the traditional Marxist-Leninist doctrine, which supposedly provided the bed-rock for all policy at this time, public ownership should dominate the economy. As a result, the case of Wenzhou's development became an issue of national concern and debate. The main question for discussion was whether the growing proportion of the private economy would affect the leading position of the state economy, and ultimately move China away from a socialist economy and society. Or from a more cynical viewpoint, perhaps we can say that the debate was how to change China's ideological stance to facilitate the rapid economic development that the private sector in Wenzhou had helped to generate.

In defence of the Wenzhou experiment, Wu Xiang, deputy director of the Rural Policy Research Centre under the State Council, argued that the overall direction and

orientation of China's economy would not be fundamentally affected by isolated events in some areas.<sup>8</sup> As long as the national economy as a whole was dominated by public ownership, then it could easily accommodate some areas where the private sector was in command. Furthermore, almost all the piece-work products produced by the household industry in Wenzhou were small products which could not affect the dominant position of the state economy. Most products of the household industry were sold in vast rural areas and remote mountainous areas, and supplemented rather than displaced existing industries. The state would still be able to use macroeconomic control methods such as taxes, credit, industrial and commercial administration and so on to influence the overall economic direction.

Some people have strongly argued against the development of private enterprises in Wenzhou, pointing to the prevalence of tax evasion and fraudulent practices, since they thought these wrong doings are capitalist restoration and should be eliminated along with private enterprises.

The public airing of the Wenzhou debate inevitably entailed the participation of central leaders. Indeed, it is inconceivable that this debate would have become public without the prompting of a central leader or leaders anxious to prove a point. It is important to note that at this stage (and at many others) further reform of the Chinese economy was being obstructed by opposition from powerful

conservative minded leaders. An open debate which would hopefully show to the Chinese people the benefits of private industry would force the hand of the conservative leaders and make it difficult for them to halt the momentum for reform. On the other hand, conservative leaders would hope to highlight the negative impacts in an attempt to influence an alternative public opinion.

The development of private rural enterprises obtained support from a group of influential leaders, including Wan Li (vice premier), Zhao Ziyang (premier), Tian Jiyun (Poliburo member and vice premier), Du Runsheng (Director of Rural Policy Research Centre under the Secretariat of the Central Committee). In particular, Zhao Ziyang, the then prime minister (and thus, ultimately in charge of economic affairs), was Wenzhou's most powerful advocate. His support for Wenzhou was developed in a now typical manner<sup>9</sup> - a personal tour to Wenzhou in December 1985 was followed by praise for what he had found at a central cadres' conference held in Beijing on 6-9 January 1986. Following this public announcement of support from the highest level, Wenzhou was approved as an experimental zone for reform in May, and an experimental Zone Office under the auspices of the Rural Policy Research Centre and the Central Committee Secretariat was established.<sup>10</sup> Wan Li entered the debate by using his close contacts with Deng Xiaoping to bring him into the pro-Wenzhou "lobby".<sup>11</sup>



Despite this support for the Wenzhou "model", more conservative leaders were not prepared to admit defeat. Although it proved difficult to oppose the pro-Wenzhou grouping in 1985, they waited until further problems emerged in the reform process to renew the attack on the dangerous capitalist tendencies in Wenzhou. During the anti-bourgeois liberalization campaign in 1987, Wenzhou was used as an example of the dangers of capitalist restoration. Similarly, after the suppression of the 4th June "democracy movement" in 1989, Wang Zhen, a conservative top Chinese leader wrote: "I have long heard that Wenzhou's political power is not in the hands of the Communist Party." The State Council Research Office (headed by Yuan Mu) responded by dispatching a group to Wenzhou for investigation, which reaffirmed the success of the Wenzhou experiment and its socialist characteristics. Undeterred, Yuan Mu rejected the findings and insisted on revising the conclusion accordingly to affirm Wang Zhen's position.<sup>12</sup> This counter-attack was in itself countered when Qiao Shi and Li Ruihuan, Central Committee Political Bureau Standing Committee members of the Chinese Communist Party, separately visited Wenzhou in August and September, and both affirmed its achievements in reform and opening up.<sup>13</sup>

The controversy on Wenzhou has cooled down since Deng Xiaoping paid a visit to south China in early 1992, and called for bolder reforms. Deng redefined "socialism" during the southern trip: "To judge whether an economic measure is

socialist or capitalist will depend mainly on whether it will develop productive forces under socialism, enhance national strength and promote the living standards of the people."<sup>14</sup> From this point of view, the development of private rural enterprises in Wenzhou is socialist. It should be encouraged. James McGregor wrote: "in essence, that it is all right to use capitalism to save socialism."<sup>15</sup>

What this discussion demonstrates is that the acceptance of local initiative and the extent of local power is tempered by the attitude and intervention of central leaders. But conversely, the success of the policy line of particular central leaders is also very much helped (if not dependent on) the successful initiatives of local authorities.

### **3.3 Policy Variations in the Desire of Local Leaders to Adhere to Central Policy**

Although central leaders' attitudes are a crucial determinant of the existence and scope of regional policy variations, local government leaders also play a very important role in regional policy variations. Provincial and lower level authorities have always been in a position to modify and even distort central policies due to their control over policy implementation. But after 1978, this ability to change the substance of central policy initiatives was expanded with the devolution of more

decision making powers (as opposed to policy implementation powers) to provincial level authorities.

Township and village leaders are generally very keen on developing rural enterprises. As noted in section 3.1 above, they have become an important component of township and village governments' fiscal considerations. But there are also more tangible benefits to local leaders from developing rural enterprises. Many have partially transferred their political power to economic power by becoming involved in running rural enterprises themselves. Their knowledge, experience and, perhaps most importantly, contacts have ensured that their personal incomes as well as the local government's income have benefited from the development of rural enterprises.

Indeed, in some rich areas, township and village government leaders have been unwilling to accept promotion to the next higher level because of the relatively low government wage scale and the prohibition against higher government cadres' engaging in private business. By contrast, in poorer more backward areas, lower-level community government leaders actively strove for promotion to state cadre status because of the financial advantages resulting from the change in household registration status from rural to urban residency.<sup>16</sup> Thus, perhaps not surprisingly, one of the determinants of how supportive of rural enterprises local leaders are is the benefits that they themselves can expect to gain from their development.



This is in turn partially dictated by the economic conditions of their area, an issue that will be dealt with in more detail in sections 3.4 and 3.5 below.

Another important factor in the development of local strategies was the ambiguity of central government policies and proclamations. With no clear and authoritative voice coming down from the centre, local leaders were free to interpret central orders in a way that best suited their own priorities.<sup>17</sup> For example, Central Document No.1 for 1983 gave entrepreneurs approval for private hiring of labour, private purchase of large-scale producer goods, and pooling of capital in private investment.<sup>18</sup> Each owner of a private enterprise in rural areas could employ one or two hands, and a person with special skills could take on no more than five apprentices. But the central government adopted an ambiguous attitude towards employing more people; although it gave no encouragement or publicity to violations of the rules, neither did it take any action to stop or punish them. This policy left room for local leaders to manoeuvre. In conservative areas such as some parts of rural Hebei, local leaders began harassing them and demanding a cut when the businesses continued to expand and proliferate.<sup>19</sup>

In contrast, local leaders in some areas went as far as to provide protection for the development of rural enterprises. One simple way of doing this was to classify private enterprises as "local collective enterprises" or "partnership enterprises". They subsequently qualified for

those advantages developed to encourage the collective sector such as tax breaks.

To return to the case study of Wenzhou, of the 225,000 private enterprises, 110,000 with a total work force of 1.76 million, were registered in this fashion.<sup>20</sup> This practice was termed trying to get a 'red hat' meaning trying to make private enterprises appear 'not that bad' according to old ultra-leftist standards. It is worth noting that the local authorities also gained from this practice as entrepreneurs were forced to hand over a portion of their profits to the administrative organizations in return for which they obtained their 'red hats'.

Local leaders have not only exercised flexibility in explaining and implementing central government policy, but they have also made their own policies. Local governments in Wenzhou and Southern Jiangsu provide the best examples of how local governments transcended the boundaries between flexibility in policy implementation, and policy making. In Wenzhou, "The policy adopted by the local governments is to let the market solve various basic problems in economic development".<sup>21</sup> After the central authorities gave approval for Wenzhou to operate a pilot scheme to test further ways of developing the commodity economy in 1986, Zhejiang Party Committee and Provincial Government of Zhejiang and Municipal Government of Wenzhou drew up the "Wenzhou Region Pilot Scheme".<sup>22</sup> The main features of the scheme are as follows:

First, the scheme provided for legal guarantees for the rights of ownership and management of private businesses and allowed free, unlimited hiring of labour. Qualifying private businesses might apply for permission to issue shares on the open market. Family businesses, joint enterprises and agricultural trades could work in conjunction with state-owned or collective industries.

Second, the scheme accelerated the reform of state-owned and collective industry through adjustment of their ownership structure and business management. Ordinary small-scale industries and enterprises were gradually "restructured, converted, leased, and sold". Some were turned into collective enterprises; some were leased out to collectives or private operators; and a small proportion were sold off, thus becoming completely privately owned. Enterprises that had been running at a loss over a long period and that had no assets to pay off their debts were to be declared bankrupt, with guarantees being provided for their workers.

Third, the scheme provided gradual price liberalization and the creation of a regional pricing system based on market prices. Three price scales were applied to basic means of subsistence: currently rationed goods continued to be priced in accordance with practical criteria and governmental regulations; some secondary products were subject to guided pricing, with upper and lower limits being set to curb fluctuation. Other products were regulated by



the market. Industrial products of daily use were subject to price liberalization, except for a small number of products subject to state allocation.

Fourth, the scheme proposed the implementation of financial reform and liberation of the capital market. Various forms of financing organizations were developed, including city credit cooperatives, and joint stock cooperative banks. Old-style money lenders might also continue to operate.

This scheme not only provided the legal guarantees for the development of private rural enterprises before their formal legalisation on a national scale, but also offered more liberal policy for the development of the market. As a result, private rural enterprises have rapidly developed ahead of other regions, and different markets have been established in Wenzhou.

In contrast, the local government in Southern Jiangsu formulated an entirely different set of policies. The main characteristic of local government policy for rural enterprises in the Southern Jiangsu region has been to discourage the development of the private sector of rural enterprises and to encourage the development of the traditional collective sector of rural enterprises.

For example, in Wuxi, community-run enterprises have a strong base. Local government in Wuxi has firm leadership over the rural enterprises and stressed the development of industrial collective enterprises. Its strategy is to

discourage the development of rural enterprises below the village level and protect the collective sector of rural enterprises as much as possible from competition for human and financial resources.<sup>23</sup> Therefore, although private enterprises are tolerated, their development has been restrained by limits on loans, restricted access to inputs, and environmental and other regulations.

One of the most distinguishing characteristics of rural enterprises in Southern Jiangsu is the strong involvement of local governments. Governments in Southern Jiangsu at various levels have played an important role in the development of rural enterprises. Jiangsu government has actively promoted the development of township and town enterprises. Former Provincial governor Gu Xiulian said: "We are emphasizing the development of rural industry that is the pillar of all industry in this province."<sup>24</sup> Jiangsu local government has also given various forms of support towards the development of rural enterprises.

First, local governments have helped rural enterprises to raise funds from both local and external sources for developing production. With more funds, it is possible to set up larger enterprises, most of which are mechanized or semi-mechanized, producing small and medium-sized items. Their technical standards are also high.<sup>25</sup>

Second, local governments have played an active role in regulating local development and forging external ties. As a result, a production structure with industry as the

dominating factor has been formed.<sup>26</sup> For example, local government in Wuxi has supplied initial funds for collective rural enterprises, shared their risks, served as a supervisory body, appointing managers and allocating workers. Workers enjoy job security but have no right of management, and their wages largely consist of piece rates and profit-related bonuses. The community government's leadership role includes providing assistance in product selection, marketing, and financing.<sup>27</sup>

Local governments also have the power to redistribute part of the profits of rural enterprises. Rural enterprises have to pay certain net incomes to village and township governments besides what they pay in taxes to the state. These funds are used to build new enterprises and to reinvigorate existing enterprises, to give various forms of subsidies and help to agriculture, and to accumulate the common welfare fund. For example, in Wuxi ten percent of profits remitted by rural enterprises is used to finance agricultural investment and support services. The government tries to keep the difference between wages of workers in rural enterprises and in agriculture relatively small, and so it imposes wage controls on collective rural enterprises.<sup>28</sup> As a result, industrial and agricultural development is fairly well coordinated, and peasant income is relatively even. According to a survey, among 454 households in two medium-income villages in Southern Jiangsu, less than 3 percent had an average annual per



capita net income of under 200 yuan, about 11 percent, had more than 1,000 yuan; and 74 percent, had 400 to 1,000 yuan.<sup>29</sup> Thus, the income of most agricultural workers is nearly equal to that of industrial workers.

A third case study, of Nanhai County in Guangdong Province provides yet a third set of policies. Here, the local government has chosen to encouraged a mix of different forms of rural enterprises, rather than emphasising either the private or the collective sector. During the early 1980s, local government in Nanhai encouraged the development of collective rural enterprises, but local leaders did not discriminate against the development of private rural enterprises. After 1978, with the development of the open door policy, the relatives of overseas Chinese started to run their own rural industry supported by foreign capital, equipment, business methods and economic information supplied by their kin. The local government has also established joint ventures with foreign (mostly Hong Kong) firms so that collective rural enterprises have been able to obtain advanced technology and to modernize their production methods.<sup>30</sup>

However, although local government has emphasized development of all forms of rural enterprises, it is not as directly involved in the management of rural enterprises as in Wuxi. Moreover, rural enterprises were less subject to macroeconomic control from the central government since rural enterprises in Nanhai could by-pass the state sector

and seek financial (and other) resources through foreign channels.<sup>31</sup>

The above three examples show that local governments have taken different policy directions to develop rural enterprises, and they have also different roles in developing rural enterprises. However, regional policy variations are not only related with variations in the desire of local leaders to adhere to central policy, but are they also involved with economic and geographical and historical factors. These factors will be analysed in detail below.

### **3.4 The Economic Legacy**

In China, all enterprises are not equal in status. Among the enterprises, township-run enterprises are lower than state-run enterprises; village-run enterprises are lower than township enterprises; private enterprises are lower than village enterprises. Higher ranking enterprises receive more preferential treatment and favours from the government, as well as more resource allocations. Therefore, local leaders prefer to support and develop higher ranking enterprises if this is a viable option. The Southern Jiangsu example is a case in point.

In Southern Jiangsu, collective rural enterprises had started to grow in China's old economic system of the 60s and 70s. For example, in Wuxi in the early 1970s, after an

intense debate, county authorities decided not to abandon rural enterprises, even though in accordance with the spirit of the times they stressed the development of agriculture and grain production. By the late 1970s, rural industrial development in Wuxi was far ahead of that in other counties.<sup>32</sup>

Therefore, Southern Jiangsu has a good economic base, rich financial resources, abundant human talents, and early development of collective rural enterprises. Higher levels of economic development in Southern Jiangsu can be used to explain why local leaders prefer to develop collective rural enterprises rather than private rural enterprises.

Nanhai County, however, is located in a highly developed and urbanized area. Rural enterprises in Nanhai like Wuxi derived much of their initial technical strength from workers who returned to rural areas in the 1960s and 1970s. Guangzhou provided rural enterprises with opportunities to obtain technical assistance in various ways. Although Nanhai does not have as strong an industrial base as Wuxi, it has greater access to foreign technology through joint ventures and processing arrangements. Rural enterprises in Nanhai are on a smaller scale. The collective sector of rural enterprises is weaker and the private sector is stronger than in Wuxi.<sup>33</sup>

Therefore, Nanhai also has a good economic base, and experienced early development of collective rural enterprises. Moreover, Nanhai has greater access to foreign



technology. As a result, many joint ventures have also been established. Since many production factors such as equipment and technology and land belong to different owners, collective rural enterprises are less predominant. Given these features, the local government is willing to encourage the development of rural enterprises at all forms of ownership.

By way of contrast, local governments in poor regions have many difficulties in developing collective rural enterprises since poor regions receive less state investment and lack economic strength. Therefore, if local leaders in poor regions want to develop rural enterprises, they have to adopt more liberal policy to encourage peasants to establish their own businesses. This brings us back to the Wenzhou region.

Wenzhou is situated opposite Taiwan across the Taiwan Strait. It was the "frontline" in the 1950s when the situation between Taiwan and the Mainland was tense. It was the hottest spot in the country during the "Cultural Revolution" in the 1960s when various factions of the Red Guard held pitched battles with guns and artillery. From 1949 to 1986, state investment in local economic activity accounted for only 1 percent of the total spent on the province, despite its area being 11 percent of the province and its population 15 percent of the province's total.<sup>34</sup> Thus, the local economy remained relatively stagnant. In Wenzhou the industrial and geographical conditions are not

conducive to supporting large sized enterprises. In the 30 years between 1949 and 1980, this area's total agricultural output value increased at an average annual rate of 4.9 percent, which was 0.5 percent lower than the national average for the same period.<sup>35</sup> In sum, the Wenzhou area has a poor basis in its collective economy, but there are more people than the land can support, and during 1949 to 1978 there was limited investment in capital construction.

Therefore, before 1978 Wenzhou had a relatively stagnant economy, and a poor base in the rural collective economy and a limited level of economic investment. Local leaders from each level of the village were willing to tolerate and even support private enterprises. In general, rural enterprises in Wenzhou are small scale. They need little investment since the cost of household industry is low, so that it has been possible to gain small profits but quick turnover in selling products by securing a good market. Most of the production units are labour-intensive handicraft and semi-mechanized operations, producing small and medium-sized commodities. They tend to produce small, low price goods which urban enterprises find it unprofitable to produce, and they depend on the process of self-accumulation to run their private enterprises.

Since Wenzhou had a lower level of economic development and little investment from the state, local government was not able to rely on collective economic strength to develop collective enterprises, and had little choice but to

tolerate and even support the development of private rural enterprises. Thus, the contrasting economic legacies in Wenzhou, Southern Jiangsu and Nanhai had clear implications for the development of rural enterprises in these areas.

### **3.5 The Importance of the Unique Geographical and Historical Factors of Different Areas**

For some scholars<sup>36</sup> the key element in determining the type of local government policy adopted to encourage rural enterprises is the degree of geographic isolation of that area. For example, they argue that local governments in geographically isolated areas receive less interference from the central government. As a result, policies that deviate (or even contradict) official central policy are more likely to remain unchallenged in these peripheral areas. It is true that Wenzhou<sup>37</sup> in particular has faced geographic isolation. However, this argument is not convincing since private enterprises have not been developed in many other geographically isolated areas. In fact, geographically isolated regions have disadvantages in securing capital and technical support from big industrial cities, and have also difficulties of access to the market. Therefore, the factor of geographic isolation can become an obstacle to the development of rural enterprises. Furthermore, as we have already seen in this Chapter, Wenzhou's isolation did not



prevent it from receiving very close central government attention in the mid and late 1980s.

Since state-run businesses and supply and marketing cooperatives do not take the responsibility for rural enterprises' purchases of raw materials and selling their products, rural enterprises have to rely on themselves. In particular, rural enterprises in geographically isolated areas have to rely on procurement and distribution personnel to sell their own products. Whether the region has enough talented people to purchase materials and sell products has been crucial.

For example, although Wenzhou is located in the mountainous areas, people in Wenzhou have the tradition to engage in business and handicraft. There are lots of skilful craftspeople and competent managers. Many of China's tailors, barbers and cooks come from Wenzhou. They are known in terms of the three professional skills: the scissors, the razors and the kitchen knives. Before liberation, the peasants worked partly in the fields, partly in family handicraft work, and partly in business. Even in the years of the "Cultural Revolution", they engaged in business activity, sometimes publicly, sometimes underground. Business tradition has been a very important factor for the development of private rural enterprises. Yia-ling Liu argued that the revolutionary legacy has been the most important factor to make Wenzhou the pioneer of private economy.<sup>38</sup> However, many other regions have a similar

revolutionary legacy, but as rural enterprises have not developed in these areas, the "isolation hypothesis" alone does not appear to be very convincing.

Private enterprises in Wenzhou are characterized by distant purchases and distant sales and belong to the category of small commodity production which is neither closely linked with agriculture nor closely linked with the local economy. The products are mainly sold in the remote cities and towns. Selling and purchasing agents are scattered around the places of origin of products, and are linked with the national specialist markets, forming the commercial network. Liushi town in Wenzhou gives an example of their operation.<sup>39</sup> In Liushi, the development process consisted of four steps: First, more than 1,300 sales people went into remote areas, selling their products in factories and mines that other sellers had rarely visited. Second, they paid close attention to the different orders at each annual national machinery and electrical products fair. Third, they tried to reduce prices through reducing production costs by making use of scrap materials from big factories to produce small commodities. Fourth, they cooperated with colleagues in Shanghai, Guangzhou, Hangzhou and other cities, making use of their larger counterparts' technology and selling some of their products through these enterprises. Therefore, as we can see from this case, rural enterprises in Wenzhou have paid close attention to the

market in developing their production and marketing strategies.

Moreover, some collection and distribution markets for nationally known small commodities have appeared in Wenzhou. In 1986 in the urban and rural areas of the whole of Wenzhou, there were nearly 400 markets, among which 113 were specialized markets. The most outstanding markets were the 10 big, well-known, nationwide specialized markets.<sup>40</sup> The market liaison basis was on households that specialized in buying and selling, involving 100,000 peasants who travelled all over the country to big and medium-sized cities and remote and backward places to buy raw materials, sell products, sign contracts and pass on information.<sup>41</sup>

Therefore, although Wenzhou region faced geographic isolation, people in Wenzhou have the tradition to do business, and have established effective market networks so that private enterprises can still develop. Although many mountainous and minority regions in western and central areas also face geographic isolation, private rural enterprises have not developed since these regions lacked talented marketing staff.

In geographical terms, the area of the Southern Jiangsu is mostly scattered around large and middle sized cities. As there are many industrial cities such as Suzhou, Wuxi, Changzhou in the Southern Jiangsu, rural enterprises can receive capital and technical support from these cities, and can also access the market. Moreover, in Southern



Jiangsu there is an ancestral relation between the cities and rural areas. Those town people who returned to rural areas brought with them not only their technical and management skills but also their networks of social connections, which are essential in obtaining market information and other assistance. Those urban people are always the initiators in running rural enterprises. For example, Wuxi has derived much of its initial technical strength from workers who returned to rural areas in the 1960s and 1970s. The proximity of Wuxi to Shanghai has provided rural enterprises with opportunities to get technical assistance in various ways. For example, rural enterprises offer both short and long-term employment to workers retiring from city factories, and also part-time work to technicians in the city and researchers in nearby academic institutions.<sup>42</sup>

Nanhai County is located in a highly developed and urbanized area about 20 kilometres from Guangzhou. The agriculture produces enough to support its own population and to export a substantial quantity of products to Hong Kong. There were many small factories in the area before 1949, but the industrial base is much smaller than in Wuxi.<sup>43</sup> The rural areas benefited from the return of skilled workers who began to set up their own factories in the countryside. Throughout history, many local people travelled and lived abroad. The overseas Chinese can bring back tangible industrial resources such as overseas remittance,

overseas capital, foreign capital, foreign equipment, raw materials. They can also bring back intangible industrial resources such as market information, management knowledge and technology.

Therefore, both Southern Jiangsu and Nanhai County have the conditions to develop collective rural enterprises since they have good geographic conditions and an ancestral relation with the cities. Moreover, Nanhai County is close to Hong Kong, and has many overseas Chinese connections. Therefore, many joint ventures have been established.

### **3.6 Conclusion**

The analysis in this chapter has displayed considerable variations in local governments' policies towards the development of rural enterprises. I have argued that the support of central leaders is the most important factor which determined the scope and extent to which these policy variations could exist and develop. However, other factors such as the changes of the central-local relations, financial incentives for local leaders, local economic legacy, geographic and historical factors, have also influenced the existence and development of regional policy variations towards the development of rural enterprises.

Regional policy variations have important implications for the development of rural enterprises. Although some regions have a weak economic foundation and geographic

isolation, rural enterprises have nonetheless been able to flourish in these regions. For example, in 1977, a Wenzhou farmer's average per capita income was only 55 yuan, amongst the lowest in the country; by 1985, the average yearly income had reached 447 yuan.<sup>44</sup> Private enterprises began to dominate state enterprises, and the ownership structure of the area fundamentally changed.

The emergence of regional policy variations towards the development of rural enterprises can reduce regional development imbalance of rural enterprises. As Lin Qingsong and Wang Tuoyu <sup>45</sup> have demonstrated, in the first few years after 1978 the government depended almost solely on collective rural enterprises to develop rural industrialization. The gap among regions had widened alarmingly since a few relatively developed areas enjoyed industrialization while the backward areas were unable to develop collective rural enterprises. Since 1984 the blossoming of private enterprises has helped narrow the gaps, and has offered new hope for solving the problem of regional imbalances.

Moreover, regional policy variations have also produced political implications. The development of rural enterprises in Wenzhou has caused national debate concerning the role of private enterprises. This has facilitated the legalization of private enterprises in China.

The experience of developing private enterprises in Wenzhou has undoubtedly become a challenge to state



enterprises. But it is also beneficial as a spur to improve management methods in state enterprises and to deepen reform further. In July, 1986, the "Regulations on Enlivening State-Owned Enterprises" were promulgated by the Wenzhou municipal government.<sup>46</sup> Aimed at extending the decision-making power of enterprises, it stipulated that the total wage bill of a profitable enterprise could fluctuate in line with its profits after tax, and an enterprise might allocate those wages in whatever form it chose. Moreover, a loss-making enterprise might be allowed limited losses, beyond which no more subsidies could be given by the government. But if the enterprise lost less than the full amount permitted, it might keep the full subsidy. Poorly run or less-profitable enterprises could be leased or contracted to individuals or collectives or could be operated as shareholding co-operatives on a trial basis with the approval of the city government. Therefore, the development of private rural enterprises has not only become a challenge to the state economy, but it has also forced state enterprises to improve their management methods.

The development of private enterprises has formed a strong political force. For example, in January 1989 in Wenzhou, 78 successful entrepreneurs established the People Run Business Association (*minying gonghui*). Moreover, one-quarter of association members were also Party members.<sup>47</sup> Therefore, private entrepreneurs represent a political force within the Party and society.

Since 1978, China has undertaken fundamental economic reforms--from the centrally planned economy to market economy. The development of rural enterprises highly depends on the market. Therefore, in the next chapter, I will discuss the implications of the measures of market reform and market expansion for rural enterprises.

1. Schurmann called these two types of reform decentralisation I and decentralisation II. See Schurmann, F. (1968) Ideology and Organization in Communist China (Berkeley: University of California Press) p.196. Eckstein prefers the terms *market decentralisation* and *bureaucratic decentralisation*. See Eckstein, A. (1977) China's Economic Revolution (Cambridge: Cambridge University Press) p.171.
2. Ferdinand, P. (1987) Centre-Province Relations in the PRC Since the Death of Mao: Financial Dimensions (Warwick: University of Warwick Working Paper 47).
3. See Tong, J. (1989) "Fiscal Reform, Elite Turnover and Central Provincial Relations in Post Mao China" in The Australian Journal of Chinese Affairs No 22, pp.1-28, and Donnithorne, A. (1981) Centre-Province Economic Relations in China (Canberra: ANU Contemporary China Centre Working Paper 16).
4. See S. Breslin, Changing Centre-Province Relations in the People's Republic of China in the 1980s, Phd thesis, University of Newcastle upon Tyne, 1993, pp.473-474.
5. Wang Huning (1988a) "Zhongguo Zhengzhi-Xingzheng Tizhi Gaige De Jingji Fenxi (An Economic Analysis of the Reform of China's Political-Administrative System)" in Shehui Kexue Zhanxian (Social Sciences Front) No 2, p.107-115.
6. Wang Huning (1988b) "Zhongguo Bianhuazhong De Zhongyang He Difang Zhengfu De Guanxi: Zhengzhi De Hanyi (Ramifications of Changing Relationship Between Central and Local Government in China)" in Fudan Xuebao (Fudan University Journal) No 5, pp.1-8 and p.30.
7. R. Hsu (1992) Economic Theories in China, 1979-1988 (Cambridge and New York: Cambridge UP) p. 2.
8. See, for example, Wu Xiang, "On the Developing Rural Commodity Economy in Wenzhou," Renmin Ribao, 4 August 1986.
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13. *ibid.*
14. "Deng the Whirlwind Rejuvenates Wenzhou," Beijing Review, June 15-21, 1992.
15. Wall Street Journal, 13 August 1992.
16. William A.Byrd and Alan Gelb, "Why Industrialize? The Incentive for Rural Community Governments," in edited by William A.Byrd and Lin Qingsong, China's Rural Industry--Structure, Development, and Reform, Oxford University Press, pp. 342-357.



17. Keith Forster notes that a similar phenomenon occurred during the Cultural Revolution. Forster, K. (1990) Rebellion and Factionalism in a Chinese Province: Zhejiang, 1966-1976 (New York: M.E. Sharpe).
18. "Several Problems in Current Rural Economic Policy (Central Document No. 1 for 1983), *Renmin Ribao* (People's Daily), 10 April 1983, pp.1-2.
19. Yan Nong, "The Development of the 'Two Households and One Alliance' in Rural Hebei," *Shehui Kexue Dongtai* (Social Science Trends), Hubei, June 1983, p.13.
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23. *ibid.*
24. Wen Tianshen, "China's No. 1 in Industrial/Agricultural Output," *China Reconstructs*, July 1989.
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26. *ibid.*
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28. *ibid.*
29. Huang Xu, *op.cit.*
30. Jan Svejnar and Josephine Woo, *op.cit.*
31. *ibid.*
32. *ibid.*
33. *ibid.*
34. *ibid.*
35. Huang Xu, *op.cit.*
36. See, for example, Yia-ling Liu, "Reform From Below: The Private Economy and Local Politics in the Rural Industrialization of Wenzhou," *The China Quarterly*, June 1992, pp. 293-316.
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38. Yia-ling Liu, *op.cit.*
39. Qiu Jian, "The Rural Markets of Wenzhou," *China Reconstructs*, November, 1988.
26. Wu Xiang, "On the Developing Rural Commodity Economy in Wenzhou," *Renmin Ribao*, 4 August 1986.
41. *ibid.*
42. Jan Svejnar and Josephine Woo, *op.cit.*
43. *ibid.*
44. Qiu Jian, "The Rural Markets of Wenzhou," *China Reconstructs*, November, 1988.
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## Chapter 4 The Implications of Market Reform and Market Expansion for the Development of Rural Enterprises

In Chapter Three, I have discussed two development models of rural enterprises. In this chapter, I will examine the implications of market reform and market expansion for rural enterprises. Since 1978, China's economy has been divided into a planned and a non-planned sector. China's rural enterprises are highly dependent on the market. The reform of the market has played a critical role in the development of rural enterprises. In this chapter, I do not intend to work out why China carried out the reform of the market and what kinds of the measures of market reform should take place in the future.<sup>1</sup> My main intention in this chapter is to analyze how the measures of market reform and market expansion influence the development of rural enterprises, and examine some characteristics of the market's use of rural enterprises. First I will analyze the measures of market reform and their implications rural enterprises. Secondly I will deal with market expansion and its implications for rural enterprises. Thirdly I will examine some characteristics of the use of the market by rural enterprises. Finally I will discuss the likely effects of further reform of the market for the development of rural enterprises.



#### 4.1 The Implications of the Measures of Market Reform for the Development of Rural Enterprises

After 1949, China adopted a centrally planned command economy. Although the experience of the Soviet Union provided the basic model for this economic system, both in its initial inception and subsequent revisions, it marks a separate and distinct economic model from its Soviet forefather. This system created a strict rationing system for key consumer goods for the entire population and the direct allocation of raw materials and capital goods for enterprises. The system kept the aggregate demand and supply of basic consumer goods under government administrative control, thus making it feasible to guarantee minimum subsistence levels to most people and to achieve artificial price stability.

Liu Guoguang and Zhao Renwei<sup>2</sup> have demonstrated that Stalin's model of a centrally planned command system in China had the following problems: First it separated supply from demand since most of the goods produced by the enterprises were regulated under state unified procurement and marketing, and the bulk of the means of production was also under state unified supply and planned allocation. There was little coordination between consumers and producers. Second, there were no objective criteria to determine the value of a product, the planned prices of many products deviated from

their values by a wide margin. Third, under planned economy, enterprises were not responsible for profits and losses, and so the enterprises and their employees made little effort to meet the consumers' demands by reducing costs and improving quality, and increasing the variety of products. Fourth, owing to ignorance of the market and backwardness of the petty mode of production, the enterprises were driven to self-sufficiency instead of specialization. As a result, there was an autarky tendency.

This system was particularly harmful to the development of rural enterprises. First, under this system, all raw materials and important production means were distributed by the state. The priority of the supply of these materials was given to the state enterprises. Rural enterprises hardly obtained raw materials and energy from the state. Second, under this system, different markets such as information markets and financial markets did not exist, making it very difficult for rural enterprises to obtain the information and funds. Third, under the provisional measures for rationed supply of grain for city and town people, people who wished to transfer their domicile or to add a member to their family had to present their household registration book and credentials for permission; when people changed jobs, they had to present a certificate from the labour department in order to transfer their household registration; when personnel settled in the villages or townships, their household

registration and grain coupons were transferred to the place where they settled. They had to get permission, or they would lose their rations. Thus, the system controlled migration of technological personnel to rural enterprises and enforced labour assignments.

After the December 1978 3rd Plenum of the 11th Party Committee, China engaged in a series of market reforms. I will discuss the implications of these market reforms within the following periods: (a) October 1979 to October 1984; (b) October 1984 to late 1988; (c) late 1988 to 1991; (d) 1991 to early 1992.<sup>3</sup> Then, I will analyze the implications of the measures of market reform towards the development of rural enterprises according to above different periods.

#### **4.1.1 From December 1978 to October 1984**

During this period, the following reform measures were introduced: First, the household contract responsibility system was implemented in rural areas, thus providing farmers with an incentive for work. As a result, agricultural output increased. This offered two bases for the development of rural enterprises. First, it provided a sufficient supply of grain for farmers to engage in rural enterprises. Second, a considerable proportion of farmers became surplus. This provided a sufficient supply of labour for rural enterprises.



Second, the state's monopoly on the purchase and marketing of agricultural products was reduced. By 1984, the number of agricultural commodities subject to compulsory state procurement had been reduced from 29 to 10.<sup>4</sup> Agricultural price reforms had increased payments for compulsory deliveries of agricultural products and raised rural income. Higher incomes had led to increased rural demand for consumer and producer goods, though the quantities supplied had been insufficient.<sup>5</sup> Thus, this created a demand market of consumer goods for the development of rural enterprises.

Although price reforms such as adjustment of ex-factory prices throughout industry and reform of the existing price management abolishing "pricing-fixing by directive" were recommended during the period 1980-1981, the plan for general price reform was not put into effect.<sup>6</sup> Thus, the reform of the market was limited during this period.

#### **4.1.2 From October 1984 to Late 1988**

In 1984 the political and economic atmosphere shifted to favor more radical reform. For example, the economic retrenchment of 1979-1983 was phased out. Inflation had dropped from 6 percent to 2.9 percent. Shops were well stocked.<sup>7</sup> Therefore, some reforms of the market took place.

During this period, the most important reform of the market was the implementation of the dual pricing system. The

decision of the State Council, in May 1984, "On further Expansion of Decision Making Power on the Part of State Run Industrial Enterprises", stipulated that there were in the planned economy and the non-planned economy, two types of material supplies for the enterprises, namely, state allocation and free purchase by individual enterprises; and the prices of the goods produced outside the state quota system could be varied within a range up to 20% higher or lower than state prices.<sup>8</sup> In February 1985, the State Price Administration and the State Material Administration jointly cancelled the 20% limit.<sup>9</sup> Thus, the dual pricing system was formally in place. The dual pricing system had very important implications for the development of China's national economy.<sup>10</sup> This system had also very important implications for the development of rural enterprises.

Its main result was to stimulate production and alleviate the pressure of demand. Since industrial enterprises that formerly had to obey government production directives had been given more freedom to produce products they could dispose of them at prices set by themselves. Thus, they had a great incentive to seek markets and profit.<sup>11</sup> As a result, rural enterprises could buy more raw materials and some products from the market. The market environment was thus much improved for rural enterprises.

However, since there were the shortages of raw materials and funds, competition existed between rural enterprises and

those owned by governments at county, provincial and central levels. Rural enterprises had an inferior competitive position compared with government-run enterprises at higher levels. The former had relied completely on the market for everything they need, the latter had been more or less guaranteed by the State a supply of production materials, advanced technology and professional people. Moreover, their products enjoyed easier access to the market due to their firmly established sales channels and information networks. These unfair conditions forced rural enterprises to pay a high price for their survival and development.

The dual pricing system also created an opportunity for producers and commercial intermediaries. Certain people with official positions or personal connections could use ties of friendship, and the power to give orders, to grab illegal profits. This was mainly because industrial growth had outstripped intermediate level support, causing bottlenecks to emerge in the supplies of coal, electricity, and transport facilities. The prices of consumer goods and raw materials on the free market were always double or triple the planned prices. In order to survive, rural enterprises had to depend on favours and gifts in order to obtain raw materials and sell their goods and get loans. However, these illegal activities were very unpopular, and the dual price system was criticized for facilitating them. These (and other) irrationalities in the economic system also contributed to economic and social



disorder during the summer of 1988, with a series of bank runs and uncontrollable panic buying in some cities. <sup>12</sup>

Since 1978 China has adopted an open door policy. There are four special economic zones, 14 port cities and three river deltas in Guangdong and Fujian provinces and around Shanghai which enjoy special privileges in order to encourage their economic development and by opening them to the outside world. In addition, the State has decided to turn Hainan Island into the country's largest special economic zone and to extend more open policies in the pilot provinces of Guangdong and Fujian. China's rural enterprises are also linked with foreign trade. Although the first step linking the rural areas to foreign trade in the post-Mao era was started in 1978 in Guangdong, the first nation-wide effort to link the rural economy with the export sector occurred in 1984.<sup>13</sup> As David Zweig has pointed out that Zhao wanted to restructure agricultural production to meet the needs of export markets. However, at this time Zhao's strategy was still limited to particular rural export bases, not extended to the whole of the countryside.<sup>14</sup>

In 1987 Wang Jian in the State Planning Commission proposed a world market-oriented economic development strategy for China's coastal areas. In this strategy he suggested that rural enterprises should play an important role in the labour intensive export economy. The arguments in favour of the development of rural export-oriented enterprises are as

follows<sup>15</sup>: there is ample cheap labour in the country's coastal areas to assist in the development of labour intensive products which still make up a comparatively large part of the world markets. Coastal areas have the advantages of cheap labour and a highly skilled workforce, better industrial facilities, more capability of scientific and technological studies and convenient transport compared with other developing nations. With independent decision-making powers and flexible management methods, rural enterprises can easily adapt to the ever changing international market. In addition, rural enterprises can make full use of local resources to reduce processing costs and improve competitiveness of the products for export. However, his arguments for the development of rural export-oriented enterprises were too optimistic since many problems remained for the development of rural export-oriented enterprises.

In 1988 China adopted the world market-oriented economy development strategy for China's coastal areas. According to this strategy, China's coastal areas, which cover 320,000 square km and have a population of 160 million, introduce flexible preferential policies to attract more foreign funds and technology, and further expand foreign trade and economic exchange.<sup>16</sup> However, the development of rural enterprises not only seriously challenged the job security of the state industrial workers, the development of rural exported-oriented enterprises but also weakened central control of foreign

exchange earning. This strategy was opposed by the planning faction.<sup>17</sup>

Moreover, the development of a rural export oriented economy has faced some problems. First, with the improvement of labour productivity in the world, the cost of labour has not occupied such a large proportion of production costs any more in many export-oriented enterprises, so that the competitive superiority of low wages has weakened. With the development of advanced technology and modern management, the decisive role of low wages in market competition has disappeared even for traditional labour intensive enterprises. Second, rural enterprises have for too long lacked information about the world market situation. The Chinese foreign trade department has always discriminated against rural enterprises in providing useful information about the international market. Unnecessary formalities in examination and approval have also made things more difficult for rural enterprises. Third, rural enterprises have also been hampered by a lack of technical personnel, raw material supply shortages and absence of direct export rights.

Although the development of rural export oriented economy has faced some difficulties, rural enterprises have been the most important growth sector of foreign trade. For example, in eastern China, there were about 35,000 township and town enterprises, employing nearly 3 million employees, earning foreign exchange. From 1984 to 1989, township and town



enterprises accumulated a total of 20 billion US dollars in foreign exchange earning for the state. In 1989, foreign trade purchases from township and town enterprises in eastern China amounted to 22.9 billion yuan, accounting for 30 percent of all foreign trade purchases in eastern China.<sup>18</sup> The open door policy and the world market-oriented economic development strategy for China's coastal areas have encouraged rural enterprises to develop an export-oriented economy, and have made it possible for rural enterprises to access international markets.

As was demonstrated in Chapter Three, this period also witnessed a considerable decentralisation of economic administrative control. This resulted in high economic growth. As a result, rural enterprises developed very rapidly. From 1986 to 1988, rural enterprises increased at an average annual growth rate of 38 percent.<sup>19</sup>

However, although grain output peaked in 1984, further grain production stagnated. Moreover, after the reform of the urban-industrial sector in October 1984, the urban industrial economy has become extremely resistant to structural change in two areas: prices and property relationships.<sup>20</sup> Finally, while there was a weakening of the instrumentalities of central administrative command planning, there was no corresponding adequate strengthening of market instrumentalities of information, coordination, and incentives.<sup>21</sup> As a result, there was overheating of the economy, inflation, widening

income differentials, and corruption. This led to the third stage, from 1988 to 1991, a period of austerity.

#### 4.1.3 From late 1988 to 1991

Faced with economic crisis and resistance by conservative forces, the government postponed further price liberation and, in late 1988, adopted a series of austerity policies.

First, the authorities introduced administrative guidelines to reduce state investment in 1989 by 20 percent and to cancel or defer a large number of projects in low priority sectors such as services, office construction and processing industries.<sup>22</sup> These measures reduced the rate of inflation from an annual rate of 26 percent in December 1988 to less than 1 percent in the first quarter of 1990, alleviated cost push pressures, and increased exports.<sup>23</sup> However, there was a marked slackening in the rate of industrial growth through 1989, which became negative in the last quarter. By the first quarter of 1990, industrial output regained lost ground and at the same level as a year earlier.<sup>24</sup> However, urban unemployment had worsened, and the large number of rural migrants had returned to the countryside.

Second, a contradictory monetary policy, relying principally on the administrative allocation of credit, was imposed. For example, the People's Bank of China set a target

of 15 percent for the growth of credit in 1989 and began stringently monitoring changes in credit supply.<sup>25</sup> During that period, state loans for rural enterprises reduced rapidly. Former Agricultural Minister He Kang asked rural enterprises to rely on their own funds to compensate for the reduction of bank credit and to practise thrift and cut unnecessary capital construction during the austerity period.<sup>26</sup>

Third, direct control on prices and marketing was introduced in late 1988. For example, local governments were required to notify the central authorities whenever they raised prices for a range of daily necessities and certain raw materials. The wage bill of the urban formal sector was frozen until the last quarter of 1989.<sup>27</sup> Rural enterprises faced severe shortages of raw and semifinished materials, particularly iron and steel materials as well as increased prices. For example, the price of coal rose from 130 yuan per ton at the beginning of 1988 to its 1989 price of 250 to 300 yuan per ton. Because of a lack of coal, the amount of electricity being generated by power plants suddenly declined. For example, a major power plant in Jiangsu, the Jianbi Power Plant with an installed capacity of 1.6 million kilowatts, in January 1989 only produced 500,000 kilowatts. The negotiated price of electricity had increased from 40 yuan per kilowatt-hour in 1988 to 65 yuan per kilowatt-hour in 1989. Since negotiated price electricity only supplied a portion of enterprise needs, more and more enterprises were buying diesel



generators, and because of the increased number of plants using them, the price of diesel oil was pushed up. It rose from 1,200 yuan per ton in 1988 to 1,800-2,000 per ton in 1989. The price of raw and processed materials also greatly increased.<sup>28</sup>

During this period, rural enterprises faced serious difficulties under the austerity programme. More than 3 million companies were shut down, merged with others or shifted to other businesses in 1989, and 8 million employee had to return to the land.<sup>29</sup>

#### 4.1.4 From 1991 to early 1992

After 1991, government policies have turned reformists again. The reform of the market has continued. In January 1991 the remaining export subsidy was abolished, and series of micro-devaluations of the yuan was begun.<sup>30</sup> On May 1 1991, the Chinese government greatly increased the sale price of grain and edible oil, prices which had stayed and unchanged for 25 years(1966-91).<sup>31</sup> In addition, the government also raised prices for railway transportation, crude oil and steel products. These price adjustment were designed to eliminate the distorted price structure.<sup>32</sup>

Reform of the financial market included establishment of a money market, including bond and stocks markets, both short-term and long-term. For example, the exchange rate of Renminbi

was slightly adjusted and the value of Renminbi reduced so that the official and market exchange rates were basically in balance.<sup>33</sup> The interest rate for savings deposits was reduced on average by one percentage point and interest rates for loans by 0.7 percentage point.<sup>34</sup> Some 25 percent of the state treasury bonds were purchased and sold exclusively by other financial organizations with satisfactory results. With approval of the State Council, the pilot share-holding system was further expanded in Shanghai and Shenzhen.<sup>35</sup>

These reform measures were successful. For example, after price adjustment of grain and edible oil took place, except for a few cities where residents queued up to buy grain and oil for a short period of time, the grain and oil market was stable and no panic buying similar to that which occurred in 1988 took place.<sup>36</sup> Further market reform will give rural enterprises even more opportunities to gain access to different markets. However, they will also face an increasingly competitive market environment putting great pressure on them to perform well. This environment will undoubtedly continue to increase the efficiency and flexibility of rural enterprises.

To summarize, since 1978, China has engaged in a series of market reforms. In the process of these reforms, the scope of the mandatory plans has been reduced and the scope of the guidance plans extended. Other economic activities were regulated partly or entirely by market adjustment in

accordance with their respective circumstances. A nationwide survey made by the State Planning Commission in 1989 found that the mandatory plans covered 17 percent of the nation's industrial production; the guidance plans of various departments of the State Council, various provinces and cities, 43 percent; and market regulation, 40 percent.<sup>37</sup> As a result, the Chinese system of material allocation has become more decentralized. Even such key products as coal and steel were produced in enterprises at both central and lower levels of control and were allocated through largely separate and self-contained channels. These reforms were vital for rural enterprises to survive and develop. Although China's market system has not been perfect, it cannot be denied that the reform of the market has made a noteworthy contribution to the outstanding development that has taken place among enterprises since 1978.

#### **4.2 The Expansion of the Market and its Implications for the Development of Rural Enterprises**

The expansion of the market has created many opportunities for the entry of rural enterprises into the market economy. Since 1978, the extent of rural and urban markets has undergone a remarkable development. Table 4.1 indicates that there has been a dramatic increase of market activity in China. The number of free markets increased from 33,302 in



1978 to 72,130 in 1989. The value of trade in the market increased from 12.50 billion yuan in 1978 to 197.36 billion yuan in 1989.

Table 4.1 The Growth of Free Markets, 1978-1989

Year	Total	Rural	Urban
1978	33,302	33,302	0
1980	40,809	37,890	2,919
1981	43,013	39,713	3,298
1982	44,775	41,184	3,591
1983	48,000	43,515	4,488
1984	56,500	50,353	6,144
1985	61,337	53,324	8,013
1988	71,359	59,178	12,181
1989	72,130	59,019	13,111

(Continued) The Value of Trade in Free Markets (billions of yuan)

	Total	Rural Markets	Urban Markets
1978	12.50	12.50	0
1979	18.30	17.10	1.20
1980	23.50	21.10	2.40
1981	28.70	25.30	3.40
1982	33.31	28.79	4.52
1983	38.58	32.99	5.59
1984	47.06	39.03	8.03
1985	70.50	52.40	18.10
1988	162.13	107.60	54.53
1989	197.36	125.00	72.36

Source:

China Statistical Yearbook (1990), State Statistical Bureau.

China has also set up a variety of markets. For example, China now has more than 800 trading centers for daily necessities, 239 wholesale markets for small industrial products, 1,267 wholesale markets for agricultural and sideline products, 72,000 urban and rural free markets and

more than 400 markets for means of production.<sup>38</sup> Many labor exchanges, science and technology markets and financial markets have also come into being.<sup>39</sup>

The markets for means of production, consumer goods, technology, information, labour services, real estate, etc. have expanded in different degrees in different regions. Nevertheless, several general patterns can be distinguished. First, the country's consumer goods market's growth is now at a more mature stage, with most of the commodity items already liberalized. The number of commodity items directly controlled by the government dropped from 55 in 1978 to 22 in 1986. The number of agricultural by-products whose prices are directly set by the government, have also been lowered from 113 items to 25, accounting for an estimated 30 per cent of total sales, the other 70 percent being sold at prices following government guide lines or market-adjusted prices.<sup>40</sup> State-dictated prices on industrial commodities have likewise been limited to items which totalled merely 40 percent. Pricing of more than 1,000 small commodities was gradually liberalized.<sup>41</sup>

In the 1980s the Chinese people's consumption erupted into what economists called an unprecedented spending spree: electrical household appliances, expensive home furnishings, and fine clothing quickly became part of the everyday life of the average Chinese family. China's urban enterprises had not taken time to complete the necessary process of structural adjustments to this consumer boom, and this created a perfect

opportunity for rural enterprises. At the same time, traditional heavy industries made the transition to light industries, and the production of small volumes of a large variety of parts and components opened more doors for rural enterprises. Therefore, the emergence and expansion of the commodity markets had created enormous business opportunities for rural enterprises.

Second, a market in materials of production gradually began to emerge. By 1986 the market dependent share of steel products reached 45%. Pig iron reached 53%. Soda ash and caustic soda reached 55% and 31%, respectively.<sup>42</sup> This indicated considerable success for the market dependent system in the circulation of materials of production. Essential materials of production used to be uniformly rationed by the State. After an enterprise fulfilled the plan of commodity production set by uniform regulations, all additional products could be sold for their own benefit. For example, rolled steel was sold at two different prices. The state-set price for one ton was 700 yuan while the market price was up to 1,400 yuan.<sup>43</sup> In general, the free market price was much higher than the state price, and this had encouraged enterprises to produce and sell more materials in the market. As a result, more materials were available in the market.

One survey<sup>44</sup> shows that although rural enterprises, mainly collective rural enterprises, also became eligible for



the supply of planned allocated materials as part of the reform of the materials supply system, the supplied materials did not amount to as much as one percentage of rural enterprise's total materials consumed. Thus, the reform of the market benefited rural enterprises. The opening of markets for the means of production reduced their difficulties in getting materials. Other surveys<sup>45</sup> show prices of materials distributed by county and rural governments were oriented to markets since most of the materials distributed by county and rural governments were purchased from markets. In some cases, materials bought from markets were bundled together and distributed together with materials purchased under plan at parity price. As a result, the price of distributed materials was either the market price or close to the market price.

However, the proportion of materials of production provided by planning systems differed for different business categories. In general, for most medium-to-big businesses planned distribution had a larger share while for small businesses it had a relatively small one, or none at all. This unequal competition among businesses differed in terms of investment and production, and limited the efficiency of the market-dependent system. The disparity and imbalance in their reliance on the market for materials of production market also weakened the system's effectiveness in regulating production and circulating commodities.

Another problem that existed in the materials of production market was that reselling had become a rampant practice due to insufficient supply. This not only triggered blind development of some commodity businesses, multiplied the distribution for some means of production, and enlarged distribution profits, but also ultimately added to the consumers' burden. This will be discussed further below. Although there were many problems in the market for materials, the reform enabled rural enterprises to advance to a new stage in which there were more opportunities to buy raw materials.

Second, other important markets such as the money market, the technology market and the labour market started to develop. For example, the stock markets in Shanghai and Shenzhen began operation with the approval of the department concerned under the State Council. In 1991, a national issuance of more than 60 types of securities exceeded 200 billion yuan; some 60 cities opened markets for the transfer of state treasury bonds; and the country had more than 500 stock exchange networks.<sup>46</sup> The country's labour service institutions in 1991 reached over 8,000, while technological development markets and business organs were around 20,000.<sup>47</sup> In sum, the market developed very rapidly in a variety of sectors.

The expansion of the market created an environment favourable for the development of rural enterprises. In both

developed and undeveloped areas alike, the main channels of purchase and sales for rural enterprises were markets, including direct procurement markets and cooperative markets among enterprises. According to a survey of rural industrial enterprises<sup>48</sup>, the enterprises were themselves responsible for their purchase and marketing of 84.6% of input goods and 90% of product sales.

Du Haiyan<sup>49</sup> has demonstrated that profits obtained from the assets in operation entirely hinge on the ability of township industrial enterprises to make use of market opportunities. Thus, rural enterprises have placed strategic emphasis on sales as well as purchases. Most rural enterprises have followed the pattern of having a ratio of one person in charge of production, two in charge of purchase, and three in charge of sales. This has led to a widely held belief that the success of rural enterprises has owed much to their marketing.

Rural enterprises' production and business activity were also affected substantially by the market situation. According to the surveys<sup>50</sup>, more than half of the sampled enterprises said that their production activities were primarily dependent upon the market. For example, in terms of enterprise fixed price regulations, market supply and demand factors have a major position in the way in which rural enterprises set prices. According to the surveys<sup>51</sup>, market supply and demand directly determined the way in which rural



enterprises set prices although rural enterprises' prices were affected by state plans.

In short, since 1978 the market has considerably developed, and a variety of markets have been established in China. The expansion of the market and establishment of different markets have created a favourable environment for the development of rural enterprises.

#### **4.3 Some Characteristics of the Use of the Market by Rural Enterprises**

Rural enterprises have gradually begun to develop some unique characteristics in the use of the market. There have not been consistent marketing channels provided by commercial units to moderate market fluctuations, and since demand has not been sustained by government planning units, rural enterprises have been unable to control markets. Thus, rural enterprises market environment has been unstable and subject to fluctuation. In order to meet changes in market conditions, rural enterprises have readjusted the make-up of their production by shifting the application of production elements within the enterprises. For example, some enterprises have a production mix of two types of industry. In other cases, some enterprises start work when market conditions are good, and stop work when market conditions are poor, using this strategy to cope with market fluctuations.

Rural enterprises simultaneously use price competition and non-price competition. Price competition is an important ingredient in rural enterprises' market behaviour. In a situation of severe market competition, enterprises face the problem of the jacking up of prices in the procurement of their raw and processed materials, and competition to lower prices in the marketing of their products.

Non-price competition has an even more important position in rural enterprise competitiveness. William A. Byrd and N.Zhu<sup>52</sup> demonstrated that there have been the different patterns of competition: imitative competition, investment competition, innovative competition. Imitative competition is that a resourceful entrepreneur finds a new product or process that has been successful elsewhere and earns high profits, and many imitators soon follow since entry is easy. Consequently prices and profits decline.<sup>53</sup> Investment competition is similar to imitative competition. However, it involves large investments of community resources to build facilities that are capital intensive, and often use advanced, sometime even imported technology.<sup>54</sup> Innovative competition is when some rural enterprises adopt innovation, which continually disrupts market equilibriums and leads to improvements in products and efficiency. It primarily involves adaptation and a continual search for new ideas and better methods from elsewhere in China and from abroad.<sup>55</sup>

In addition, rural enterprises have used several other improper methods to compete with state enterprises. During 1980s, state enterprises engaged in structural reforms. The shrinking of administrative controls and the strengthening of the profit motive for state enterprises under the reforms have resulted in rapid growth of activities such as barter trade, and speculation on commodity quotas at state prices.<sup>56</sup> Rural enterprises could obtain part of state enterprises's profit by such means as giving sales commissions, paying sales agents, and making out blank invoices. Although rural enterprises had to pay much more for inputs, they often boasted higher economic benefits.<sup>57</sup> For example, in rural enterprises in Jieshou 3-5 percent of the value of purchased inputs or of products sold could be drawn out as operational fees and funds to gain access to supply and sales links.<sup>58</sup>

In addition, during early 1980s, it was very common that rural enterprises used agricultural and sideline products as quasicurrency to buy raw materials and sell their goods to state commercial departments because of shortages and high prices of agricultural and sideline products. In counties where rural enterprises were highly developed, agricultural and sideline products were often used as a medium for establishing cooperative ties with urban industrial bases.<sup>59</sup>

Rural enterprises have encouraged widespread participation by enterprise staff in obtaining supplies and promoting sales. Enterprises in Wuxi, for instance, used three main methods



when they hired permanent supply and sales personnel, part-time supply and sales personnel and temporary supply and sales personnel to obtain supplies and promote sales.<sup>60</sup> Moreover, supply and sales personnel in rural enterprises in general had high incomes in order to give them an incentive to sell more products. The income of supply and sales personnel was generally several times higher than the average for all employees and might even exceed a factory director's salary. Some sales people could earn more than 100,000 yuan a year.<sup>61</sup>

Thus, non-price competition has become an important component in rural enterprises' market conduct because of the restrictive market environment in which rural enterprises have faced.

As the growth of rural enterprises expanded, competition became increasingly intense. As a result, many industrial product markets in which rural enterprises dominated or were important, suffered declining profit margins. According to studies conducted by the State Council's Rural Policy Research Center,<sup>62</sup> 48 per cent of the same enterprises have competitors in their own township. Sample enterprises frequently cite "society's limited supply capability," and "too many enterprises need the same kinds of raw materials and energy resources". They also blame poor sales on "overproduction of the same kinds of production". The studies showed that, based on sample enterprises, the value of output per hundred yuan of fixed assets rose from 291 yuan in 1981 to 320 yuan in 1985,

but actual pretax profit fell in every year, from 64.5 yuan in 1981 to 47.5 yuan in 1985.<sup>63</sup>

The reasons for this over-competition and lower profit among rural enterprises were as follows. First, because the prices of the country's farm product were still irrational, simple agriculture was reduced to a low-profit, or no-profit basis. Accordingly, "relying on industries to supplement agriculture" or even "using industries to support agriculture" was a way of shoring up the farm economy. This was the reason behind the zealous rush to set up local-owned enterprises. Setting up rural enterprises became the official business of many local administrative organs in a majority of China's rural communities. Because rural enterprises were fairly profitable they could afford many appropriations, and they were the source of welfare support for the village people. As a result, there were more and more rural enterprises which became progressively smaller; they were less and less profitable in a market which had become increasingly competitive.

Second, rural enterprises had more difficulties in assessing financial, commercial, or information markets. This was why rural enterprises often reacted slowly to market signals, and it also accounted for their chaotic investment behaviour. Rural enterprises which entered the market early when profit margins were high, could survive and prosper even when margins became narrower, but more recent entrants faced

greater difficulties. The increasing size and changing structure of rural enterprises themselves and continued increases in urban and rural individuals' income had created numerous opportunities and market niches. But the new opportunities were often used to best advantage in the more advanced areas and by well-established firms, whereas profit margins of rural enterprises in the backward areas were narrow.

In short, rural enterprises' production and business activity are determined substantially by the market situation. There is the simultaneous existence of price competition and non-price competition in rural enterprise competitiveness; both are important, but the later is more critical. Rural enterprises' market environment has been unstable and subject to fluctuations. Many industrial product markets in which rural enterprises dominate or are important have thus been characterized by declining profit margins.

#### **4.4 The Likely Effects of Further Reform of the Market on the Development of Rural Enterprises**

Since 1978, reform of the market has had an important impact on the development of rural enterprises. Although China's free market system has not been completely established, the development of the market has been extremely helpful in boosting rural enterprises. Rural enterprises, free



from state plan restrictions, have been able to buy much needed raw materials and equipment on the market and get financial assistance from society and individuals. Du has indicated that "changes in the macroeconomic environment and in market conditions created space for the survival and expansion of TVP industry."<sup>64</sup> In fact, this conclusion can be extended to affirm that changes in the macroeconomic environment and in market conditions created space for survival and expansion of rural enterprises.

Therefore, further reform of the market is very important in relation to the future development of rural enterprises. However, further development of the market is highly dependent on the development of politics at the national level in China. As I have discussed in Chapter Two, during late 1988 to 1991, the central planners have prevailed, rural enterprises were a major target of this retrenchment policy, and rural enterprises have faced a considerable shortage of materials and funds. At least two-thirds of the enterprises were affected, causing enormous losses to local interests and huge rural unemployment.

As I have discussed above, rural enterprises have used different strategies to cope with market fluctuations. The reporter for *the Economist* Journal indicated: "it finds that the non-state businesses grow bigger and stronger still, making the next clampdown in favour of state firms that much harder to impose and maintain."<sup>65</sup> Despite the national

retrenchment policy, rural enterprises have managed to survive and even expand.

The further expansion of rural enterprises' markets, however, faces serious challenges from both urban enterprises and local protectionism. China's urban enterprises are undergoing structural changes, and their production is less dictated by mandatory plans. Urban enterprises and rural enterprises compete under the most unfair terms; urban enterprises unlike rural enterprises have huge capital, advanced technologies, and well-trained personnel; they are well supplied with raw materials under state plans, and they have well-established sales channels and good information networks; more important, large industries enjoy economies of scale beyond the reach of rural enterprises. Therefore, when state enterprises begin to enter the commodity market in a grand style to compete with rural enterprises, rural enterprises will be severely tested.

Rural enterprises have also faced serious local protectionism. This has restrained further expansion of rural enterprises's markets. During the late 1980s, some local leaders tried to safeguard their local interests by creating barriers and checkpoints to prevent goods leaving their territory, with some provinces even employing armed police forces and militia units at provincial borders.<sup>66</sup> Other provinces adopted more sophisticated protectionist methods. They used the central government austerity policies and its

programmes for strengthening market management, and rectifying wholesale commerce and control sales of fake and inferior products, as pretexts for excluding goods from outside the region. Some provinces even imposed fixed ratios on the sale of goods by commercial departments, wholesale trades and retail stores.<sup>67</sup>

Thus, if rural enterprises want to expand their markets, they must change their marketing strategy. At present, rural enterprises in developed regions lack opportunities for foreign market development. At the same time, rural enterprises in backward regions have very little ability to seize upon development opportunities and are presented with few opportunities to develop nonagricultural production. The best strategy would be to push the rural enterprises in developed regions into the international market. This would also simultaneously create further development opportunities for the rural enterprises of mid-level regions and backward regions. Moreover, rural enterprises should readjust their product mix. Retail strategy should be changed. Rural enterprises should not only consolidate their existing partnerships to open up product retail sales channels, but also hold goods ordering fairs and exhibitions to promote the sale of their products. Rural enterprises should further cooperate with urban enterprises so that they might expand their markets and overcome their shortage of technology.



Since 1978, the government has changed rural employment strategies and regional development strategies. The changes of these strategies have important implications on the development of rural enterprises. In the next chapter, I will examine how the changes of the strategies have influenced the development of rural enterprises.

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## **Chapter 5 The Implications of Rural Employment and Regional Development Strategies for Rural Enterprises**

In the previous chapter, I have discussed how market reform and market expansion influenced the development of rural enterprises. In this chapter, I will discuss the implications of the government strategies for rural employment and regional development policy for rural enterprises.

### **5.1 Government Strategies for Rural Employment and their Implications for Rural Enterprises**

China's countryside has experienced a rapid decline in its mortality rate and an increasing life expectancy while at the same time the implementation of family planning policies was less successful. As a result, the natural increase in population in rural areas is much higher than in the cities. Thus, the rural population has increased and will continue to increase significantly till the next century. Moreover, the introduction of the rural responsibility system from 1978 to 1983 has been a major incentive to improve the efficiency of labour use. Further mechanization will also free more farmers from their land. Additionally, since the revival of China's rural economy, an increasing amount of agricultural land has been lost to non-

agricultural use. Therefore, less labour is required on the land, and surplus rural labour has gradually increased. Official information has predicted that by the year 2000 this surplus labour will increase to more than 200 million people.<sup>1</sup>

Since the end of the 1970s, the success of the rural reforms and China's insufficient amount of cultivated land compared with the size of its labour force, resulted in large numbers of surplus farm labourers. Rural surplus labour force could not move to the cities since the cities had yet to find a way to solve their own unemployment problems. The government sought to deal with the problem locally rather than permitting thousands of people to swarm into the cities. The main strategy was to encourage peasants to set up rural enterprises through self-accumulated capital and bank loans. In 1988, rural enterprises employed 95 million people, a quarter of the rural labour force.<sup>2</sup> Rural enterprises have played a very important role in solving the problem of rural surplus labour. In this section, I will concentrate on the Chinese government's measures for rural surplus labourers and employment in rural enterprises rather than discuss the general issues of rural employment. In doing so, I will first briefly assess the extent of unemployment in rural areas. Secondly, I will examine the government's strategies for solving rural underemployment. Thirdly, I will consider the relation between the development of small towns and rural employment. Fourthly I



will discuss the employment in rural enterprises. Finally, I will analyze the future prospects for employment in rural enterprises.

### 5.1.1 Unemployment in Rural Areas

China is the most highly populated country in the world. The population density per square kilometre of the 30 provinces, autonomous regions and municipalities on the mainland, was 118 persons in 1990.<sup>3</sup> As table 5.1 shows, the majority of Chinese people are still engaged in agriculture.

**Table 5.1 Labour Force Employed in Industrial and Agricultural Sectors (Year-end figure) 10 thousand**

Year	Labour force employed in:		Composition(%)	
	Industry	Agriculture	industry	Agriculture
1952	1,246	17,317	6.7	93.3
1957	1,401	19,310	6.8	93.2
1962	1,705	21,278	7.4	92.6
1965	1,828	23,398	7.2	92.8
1970	2,809	27,814	9.2	90.8
1975	4,284	29,460	12.7	87.3
1976	4,692	29,448	13.7	86.3
1977	4,809	29,345	14.1	85.9
1978	5,009	29,426	14.5	85.5
1979	5,340	29,425	15.4	84.6
1980	5,600	30,211	15.6	84.4
1981	5,796	31,171	15.7	84.3
1982	5,930	32,013	15.6	84.4
1983	6,023	32,510	15.6	84.4
1984	6,338	32,538	16.3	83.7

Source: Statistical yearbook of China 1985 (English Edition), compiled by the State Statistical Bureau, PRC. Oxford University press, Oxford, New York, Tokyo, 1985

This proportion is not only higher than that in the developed nations but also higher than that in many developing countries.

Since 1949, urban migration in China has been strictly controlled. As Taylor noted, "Administrative measures, such as the household registration system and the urban grain ration system have traditionally served as barriers to the spontaneous migration of peasants to large cities."<sup>4</sup> As a result, China's farmers have been forced to stay in rural areas to make a living. Taylor argued that "The primary reason why rural surplus labour has continued to exit in China is that tight constraints on rural to urban migration and the existence of fixed land resources in rural areas have forced many more Chinese farmers to make a living from tilling the soil than is necessary."<sup>5</sup>

It is difficult to measure exactly how many surplus labourers there are in China's rural areas. Jeffrey R. Taylor<sup>6</sup> has summarized three approaches used by Chinese scholars to calculate rural surplus labour: the "experience method"<sup>7</sup>, the "estimation method"<sup>8</sup>, and the "labour norm method"<sup>9</sup>. Each of these methods shows that there is a huge surplus of labour in China's rural areas. The different findings by the different analysts indicated the same conclusion: more than 100 million were redundant and about 30 per cent of China's rural work force was in surplus.<sup>10</sup> Furthermore, the number of rural surplus labourers will increase in future. China will have 240 million to 260

millions surplus workers by the year 2000, most of them in rural areas.<sup>11</sup>

In 1991, it was estimated that along the coast migrants numbering about 23 million to 80 million were looking for work.<sup>12</sup> One southern city, Guangzhou, has attracted a floating population estimated at 516,000. The situation became so severe that the officials issued an "urgent circular" for "the greatest efforts possible to keep them from leaving home".<sup>13</sup> If the Chinese government can not provide enough jobs for its surplus rural labourers, China's social and economic development will be seriously disrupted. Solving rural surplus labour has become a very important issue.

**Table 5.2 Number of Persons Entering Employment in Cities and Towns**

Item	1978	1979	1980	1981	1982	1983	1984
Total.....	544.4	902.6	900.0	820.0	665.0	628.3	721.5
1. Major sources							
Labour force in cities and towns	274.9	688.5	622.5	534.3	408.1	406.5	449.7
Rural labour force.....	148.4	70.8	127.4	92.0	66.0	68.2	123.0
Graduates from university, colleges							
secondary technical schools and workers training schools..	37.7	33.4	80.0	107.9	117.4	93.4	81.7
Others.....	83.4	109.9	70.1	85.8	73.5	60.2	67.1
2. Assignment							
State-owned units..	392.0	567.2	572.2	521.0	409.3	373.7	415.6
Collective-owned units in cities and towns..	152.4	318.1	278.0	267.1	222.3	170.6	197.3
Individual labourers in cities and towns..		17.0	49.8	31.9	33.4	84.0	108.6

Note: (1) Unit = 10 thousand



(2) Assignment in state-owned units in 1984 includes persons assigned to joint units.

(3) Source: Statistical Yearbook of China 1985 (English Edition), compiled by the State Statistical Bureau, PRC. Oxford University press, Oxford, New York, Tokyo, 1985

The number of persons entering employment in cities and towns is still small. Table 5.2 shows that there were only 7.215 million people entering employment in cities and towns in 1984. At planned economic-growth rates, industry will only absorb 7 million a year. By the end of the century, therefore, the number of unemployed workers in China could have risen to 250-300 million.<sup>14</sup> It is impossible for the Chinese government to invest huge funds to solve the problem of rural unemployment. China has to find other ways to solve this problem.

### **5.1.2 Strategies for Rural Employment**

Thomas G. Rawski and Jeffrey R. Taylor<sup>15</sup> indicated that the Chinese government decided on the following strategies to deal with rural employment in China before 1978:

The first strategy was to raise the labour intensity of farming by promoting multiple cropping, intercropping, deep ploughing, extensive fertilization, and expanded irrigation. Taylor demonstrated that average annual labour expended per hectare increased sharply from 1953 to 1978.<sup>16</sup>

The second strategy was to organize the construction of irrigation canals, dams, roads and other forms of rural

infrastructure to reduce underemployment. In particular, during the winter months, rural construction campaigns increased labour utilization.

The third strategy was to develop urban industry to recruit rural labour. There were considerable numbers of peasants recruited into urban industry during the Great Leap Forward and during the Cultural Revolution, when urban youths were sent to rural areas.

The final strategy was to develop rural enterprises to absorb surplus rural labour. However, this did not become an important strategy for rural employment before 1978. Developing rural enterprises was considered as a supplement to agricultural development rather than as strategic measure to increase rural employment.

Since 1978 when the production responsibility system was introduced, rural surplus labourers have become visible as a serious social problem. A number of scholars have discussed possible ways to deal with this problem.<sup>17</sup> Three main strategies can be identified: (1) leaving the land and the native place, (2) not leaving the land, nor the native place, (3) leaving the native place but not the land.

Leaving the land and the native place means that rural labourers enter the cities. The income differential between urban inhabitants and peasants provides a strong incentive for farmers, especially young people, to flow into the cities. Since 1978, a considerable number of peasants have gone to the cities to work as maids, housekeepers and

tailors, and to open restaurants. Some peasants entered urban factories and were officially employed, but most have been accepted as contract workers and casual labourers. However, as Feng Lanrui and Jiang Weiyu <sup>18</sup> have argued, the cities' accommodation capacity for rural labourers is restricted by the number of jobs available in the cities. In addition, the unchecked entry of peasants into the cities was bound to cause difficulties in the areas of housing, transportation, health care and administration. Some economists have proposed that the Chinese government should encourage the peasants to enter the cities and open factories to develop medium scale cities to large scale. However, as Feng Lanrui and Jiang Weiyu pointed out: "this proposal was still at the stage of theoretical study and policy exploration and has not become a reality."<sup>19</sup>

Not leaving the land, nor the native place has two elements: first it refers to the adjustment of the internal structure of crop farming. On the one hand, this strategy would reduce the acreage sown to grain crops and labor input. On the other hand, it would expand the acreage for labor-intensive economic crops and labor input. Second, it refers to the development of peasants' part-time production. When peasants are in slack seasons, they engage in diversified undertaking, including industrial, commercial, transport, labour and other service businesses and various kinds of household sideline production. However, this strategy has two limitations: first, there is the limitation



of adjustment of the production set-up within the framework of farming because of the inadequate scientific and technological knowledge, the decrease of land, and the increase of population.<sup>20</sup>

Leaving the land but not the native place means peasants set up rural enterprises locally. This can include peasants engaging in rural enterprises full-time or part-time. After 1978, peasants have been allowed to engage in non-farming activities. They undertake industrial, commercial, building, transport and service business near their small towns or their villages but they do not change their permanent residence registration nor their grain ration relations. Their families still stay in the countryside.

Many articles in Chinese journals have been published to support the third strategy. The main justification of this strategy can be seen in chapter 2. However, some Chinese scholars<sup>21</sup> hold that China should not depend on the small towns solely to absorb the rural surplus labour force in their localities, when the rural population still account for 80 per cent of China's total population. They point out that the density of population in the cities, not including the 16 major cities such as Shanghai and Beijing, is not high. It is totally possible for these cities to provide employment for rural surplus labour.

Feng Lanrui and Jiang Weiyu<sup>22</sup> have also argued that while it is true that most rural enterprises are located in

areas near and closely related to large and medium-sized cities and coastal areas, in the areas far from big cities and conditions for agricultural production are poor, and peasants even have problems of obtaining adequate food and clothing. It is impossible for them to set up rural enterprises to solve the problem of rural surplus labour.

Nevertheless, although the strategy of leaving the land but not the native place has some limitations, the Chinese government has adopted this strategy since 1978. On the one hand, the emigration from rural areas to urban areas has been strictly controlled. On the other hand, the construction and development of small towns utilizing a large number of surplus rural labourers has been undertaken to prevent their immigration into big cities. Over the years, millions of peasants have left the land, but not the village, to enter rural enterprises. Their practice has become a strategic principle formulated by the Chinese government since 1978. One official document clearly indicated this strategic principle.

"It is estimated that by the end of this century China's countryside will have 450 million (labour force). By then, crop cultivation will be able to employ only 30 percent of the labour force, and forestry, animal husbandry and fishery, just 20 percent. Another 10 percent can find employment in the cities, leaving 40 percent looking for work in other directions. They will

mainly be employed in industry, construction, transportation and communications, commercial undertakings and other service trades in the rural towns as well as the family-operated industrial and sideline occupations in the rural areas (towns included), otherwise they will become a serious social problem."<sup>23</sup>

Thus, the development of rural enterprises represents an important strategy of solving the employment problem in China.

### **5.1.3 The Development of Small Towns**

Since 1978, China's government has maintained tight control to prevent peasants migrating to big cities, but it has taken a more liberal policy in allowing peasants to work in small towns. The small town boom has provided job opportunities for millions of peasants in industrial production, commercial activities and various kinds of service trades.

Many Chinese scholars<sup>24</sup> supported the development of small towns. The main arguments are as follows: small towns can link the urban market to the rural market since small towns can serve as distribution centres for agricultural and sideline products as well as industrial goods. Small towns can become processing centres for agricultural and sideline products and play a supporting



role for urban industries. Furthermore, small towns can enrich the cultural life of peasants, and change the overall relationship between cities and the countryside and develop the rural economy. Finally the policy serves to narrow the gap between town and country. The assumption is that China's cities are already fully expanded and their factories and population have reached saturation point. The growth rate of population in middle-sized cities can basically meet the needs of their own development. So the many small towns in China, which have plenty of room for development and can hold many people, are targeted for expansion. The surplus labour in the rural areas should be encouraged to work in small towns nearby their homes. This can help the big and middle-sized cities reduce the pressure of increasing population and avoid the "city disease" caused by the expansion of population.

Fei Xiaotong, a renowned Chinese sociologist, strongly supported the development of rural enterprises in China.<sup>25</sup> He pointed out that during the process of industrialization in capitalist countries, many peasants in the countryside were on the brink of bankruptcy. The farmers were forced to leave, and they swarmed into the cities. Industrialization in China was, however, following an utterly different road from that of capitalist countries. On the basis of a prospering agricultural sector, it could run collectively owned township industries. These industries, by assisting, consolidating and promoting the agricultural economy,

brought about the simultaneous development of agriculture, sideline occupations and industry.

Having to meet China's rising food requirements with an agricultural work force that is increasingly composed of the elderly, women and children, and those with relatively low educational levels, is a recipe for disaster in the eyes of Chinese policy makers. To counter this trend, the authorities have strongly encouraged part-time farming, rather than a complete migration from the land for rural migrants, which in any case would have been impossible for the Chinese government to absorb in the cities. Since rural underemployment in China has traditionally been seasonal, peasants have long been encouraged to do jobs in small towns, but return home to help farming when labour is short of supply in the busy planting and harvesting seasons.

Thus, the Chinese government's policy was to actively encourage peasants to move to small towns located near farmers' plots rather than to large and medium-sized cities. For example, in April 1983 the promulgation of the State Council's "Regulations Concerning Co-operative Endeavours of City and Town Labourers" eased barriers to urban entry by allowing peasants to work in market towns while retaining their rural household registrations.<sup>26</sup> A further loosening of constraints on rural-to-urban migration took place when the State Council released its circular on "Questions regarding the settlement of peasants entering villages" in October 1984.<sup>27</sup> This regulation was extended to small towns,

and has been popular despite the fact that residents of these towns must obtain their own food, and cannot rely on urban grain reserves. This means that voluntary migration to urban areas is permissible under the condition that grain is provided by themselves.

With the encouragement of China's state policy, the small towns have mushroomed. There were about 8,000 medium sized and small towns across the country, in addition to 50,000 rural market towns in 1986.<sup>28</sup> Small towns include towns, county seats and factory and mining districts and commercial centres. Towns are administrative divisions ratified by the provinces, municipalities and autonomous regions according to State Council's regulations. They are equivalent to townships under the county governments. Generally, each county has one town. Occasionally there are several towns in one county. Each county has a county seat. Most of the county seats have city or township governments. In 1982, there were 2,800 county seats.<sup>29</sup> Factory and mining districts refer to those industrial and residential areas independent of nearby cities and towns. They do not have city or township governments.<sup>30</sup> There were 54,000 commercial centres, most of which are also the seats of township governments (the people's communes in the past), and they still have the foundations for light industry, handicrafts, commerce and services.<sup>31</sup>

Small towns have the characteristics of both the cities and the countryside, and of industry and agriculture.



Some of them have been gradually developed into new kinds of medium-sized and small cities. The growth of small towns has changed the relationship between cities and the countryside and has enabled rural enterprises to concentrate in small towns. Small towns have been built into comprehensive economic, technical and cultural centres for the development of agriculture, industry, commerce and transportation services in which rural energy resources can be put to more rational use.<sup>32</sup>

Small towns help absorb the surplus labour force and check the flow of peasants into large and medium-sized cities, by providing job opportunities for millions of peasants in industrial, commercial activities and various kinds of service trades. It is estimated that by the end of this century China's rural towns will provide jobs for 300 million people no longer needed on the farms, a figure amounting to 40 percent of the total rural population.<sup>33</sup>

In summary, the Chinese government's policy of encouraging the development of small towns has stimulated a boom for small towns and created favourable conditions for production and investment for rural enterprises. As a result, the development of small towns in China has created immensely more employment for peasants.

#### 5.1.4 Employment in Rural Enterprises

The development of rural enterprises has played a very important role in absorbing surplus rural labour. In 1989 township enterprises employed 95.4 million people in the countryside, making up 23.8 percent of the country's labour force.<sup>34</sup> As Taylor<sup>35</sup> has indicated, agricultural employment in rural areas grew at an annual average rate of less than one per cent between 1978 and 1986, whereas rural non-agricultural employment has quadrupled in the short span of nine years.

However, the development of rural enterprises of opportunity and ability has been extremely uneven because of both comparative economic advantage and China's regional development strategy. As a result, the imbalance development of rural enterprises has made an important impact on spatial distribution of rural employment. Employment in rural enterprises is highly concentrated in the coastal provinces and the municipalities of Beijing, Tianjin, and Shanghai. I will analyze this issue later.

The majority of workers in rural enterprises are now engaged in industrial activities. The rest are engaged in agriculture, construction, transport, commerce, catering and the service trade. The precise breakdown of employment in rural enterprises is shown in the following tables. The Tables indicate that 60-70 percent workers in rural enterprises were engaged in industrial activities. As the

different branches of rural industries are analyzed, appendix 1 shows that a large proportion of employment in both townships and villages run industries involved in manufactured goods of building materials and other non-metal minerals, garments, yarn and farm equipment. Rural industries not only account for a large proportion of employment in rural enterprises but also play a very important role in China's national economy. For example, in 1990 rural industries supplied almost one-third of China's coal, cement, paper and silk products, and 60-80 percent of the country's garments, yarn and farm equipment.<sup>36</sup>

**Table 5.3. Breakdown of Employment in Rural Enterprises**

Year	1978	1981	1984	1987
Total	2826.56	2969.56	5208.11	8776.40
Agriculture	608.42	379.94	283.93	244.11
Industry	1734.36	1980.80	3656.07	5265.37
Construction	235.62	348.83	683.49	1364.00
Transportation	103.83	107.38	129.30	615.35
Commerce, Catering and Service trade	144.33	152.61	455.32	1287.57

Unit: 10,000 persons

Source: Statistical Yearbook of China 1988 (Chinese Edition)  
Compiled by the State Statistical Bureau, PRC. Chinese  
Statistical Press, August 1988, p.288

Note: The data in 1978 and 1981 only included the number of  
workers within village-run and township-run enterprises.  
The data in 1984 and 1987 include all workers of both  
private and collective sectors of rural enterprises.



**Table 5.4. The Percentage Breakdown of Employment in Rural Enterprises**

Year	1978	1981	1984	1987
Total	100	100	100	100
Agriculture	21.5	12.8	5.5	2.8
Industry	61.4	66.7	70.2	60.0
Construction	8.3	11.8	13.1	15.5
Transportation	3.7	3.6	2.5	7.0
Commerce, Catering and Service trade	5.1	5.1	8.7	14.7

Source: as above.

The number of labourers in secondary industries, including food processing, sideline production, small mines, manufacturing and building, reached nearly 39 million in 1985, 73.7 percent more than in 1980. Finally tertiary industry, involving transport, commerce and service businesses, employed more than 28.4 million workers, 135 percent more than in 1980.<sup>37</sup> Nevertheless, rural industrial employment has grown at a somewhat slower rate than other sectors of rural enterprises. The reason is that peasants have shown more interest in investing their funds in housing. This has created vast opportunities for individuals transporting the materials and supplies that these sectors need.

The majority of employees in rural enterprises are from rural areas. A survey in 1987<sup>38</sup> showed that 88 percent of employees in these enterprises were rural people, the rest urban. Each of these worker families had an average of 2.82 able-bodied men, with 1.64 persons working in rural enterprises and making 63.6 percent of the family's total

income. As many as 91 percent of these households still had contracted fields which supplied them with their grain needs and 71 percent of enterprise employees took part in farming during the busy seasons.<sup>39</sup> This indicates that workers in rural enterprises still have a close relation with agriculture.

However, the rate of increase in employment in rural enterprises has slowed down. He Kang, chairman of the China Township Enterprise Association, has disclosed<sup>40</sup> that in the first five years of 1980s the increase of employment in rural enterprises was 44 million and in the last five years 22 million, so in the former the annual average was 8 million and in the latter the annual average was 4 million.<sup>41</sup>

During late 1988 and 1991, the Chinese leadership implemented a retrenchment policy, and imposed tight a policy on finance and the supply of raw materials for rural enterprises. In the countryside many rural enterprises have been forced to close down. The policy of retrenchment increased the local burden of surplus rural labour. Since rural enterprises were the major way of easing the problem of too many people tilling a fixed area of land, soon after this road was obstructed, albeit temporarily, large-scale bankruptcy of rural enterprises, occurred and squeezed large number peasant-workers out of employment. This has been the major cause of the so-called mangliu or 'blind population mobility' of roaming unemployed workers, representing a

potential threat to social stability. The information indicated that township enterprises absorbed 50 percent less rural workers in 1989 than 1988,<sup>42</sup> and about 3 million rural enterprises were closed down in 1989.<sup>43</sup> Especially in the construction sector many former peasants have been fired and sent back to the countryside. For example, Shanghai cut its contingent of construction workers by 100,000 or one-seventh in 1989 in an attempt to curb excessive capital construction.<sup>44</sup>

Moreover, during this period, some conservative leaders did not want the development of rural enterprises to threaten the dominance of state enterprises in the national economy, and tried to control the development of rural enterprises. They planned that during 1990s only about 3 million persons will be assimilated every year, so the total will be 120 million persons.<sup>45</sup> However, according to the preliminary plan, the total output value of township enterprises should double by 1990 over 1985, and then have a two-third increase by the year 2000. About 170 million labourers will be employed.<sup>46</sup>

However, although China's leadership prefers to develop state enterprises rather than rural enterprises, state enterprises can not provide sufficient opportunities for employment. According to statistical predictions, there will be an average increase of nine million new labours annually during the Eighth Five-Plan, and an average increase of seven million new labourers annually during the



Ninth Five-Year Plan. By the end of the century China will have 500 million agricultural labourers. Only about 200 million of them can be absorbed by agriculture, and while township enterprises can absorb 140 million, this still leaves about 160 million labourers.<sup>47</sup> Since the Chinese government can not afford the social risk of disturbance, it will still have to depend on further development of rural enterprise to solve the problem of rural surplus labour.

Future rural employment trends include "a continuing decline in agriculture's rural employment share, and a rapid increase in the number of workers in industry, construction and other non-agricultural sectors".<sup>48</sup> However, predictions of the future development of different sectors of rural enterprises are quite varied. China's two research reports on this issue described by Taylor<sup>49</sup>, presented different findings. One report suggested that the employment growth rate in rural industry, construction, and other non-agricultural sectors will be roughly the same. The second report suggested that job creation in industry, and construction will be much lower than transport, retail and wholesale trade, and services. Past experience suggests that this second report is more convincing. The rural employment trends from 1978 to the present show that industry accounted for 60 percent, while transport, retail and wholesale trade, and services increased more rapidly. For example, workers in transport sector of rural enterprises increased from 3.7 percent of total workers in 1978 to 7.0 percent in 1987.

China faces serious shortage of transportation and service sectors. Thus, employment in transport, retail and wholesale trade, and services is likely to increase at a higher rate. The rate of employment in rural enterprises will still increase.

## **5.2 Implications of Regional Development Strategies for Rural Enterprises**

In this section, I will discuss the impact of China's regional development policies for development imbalances of rural enterprises. In doing so, first, I will examine regional development imbalances of rural enterprises, then I will analyze the impacts of China's regional development policy for regional development imbalances of rural enterprises.

### **5.2.1 Regional Development Imbalances of Rural Enterprises**

China can be divided into three regions: the coastal developed region, the central region, the interior backward region. The coastal developed region includes the nine provinces and municipalities of Shanghai, Tianjin, Beijing, Jiangsu, Zhejiang, Liaoning, Shandong, Guangdong and Hebei. The central region includes the 11 provinces of Shanxi, Fujian, Jilin, Hubei, Heilongjiang, Henan, Anhui, Shaanxi,

Jiangxi and Sichuan. The interior backward region includes the 10 provinces and autonomous regions of Ningxia, Gansu, Neimenggu, Guangxi, Xinjiang, Hainan, Yunnan, Guizhou, Qinghai and Xizang.

Ye Bingsheng used two indexes to analyze regional development of rural industry in 1988: the value of the rural industry output per capita of agricultural population<sup>50</sup>, and geographical density<sup>51</sup>. The coastal region's value of the rural industry output per capita of agricultural population was 5.2 times that the central region and 14.2 times that of the interior region. The geographical density of the coastal region's value of rural industry output was 8.5 times that of the central region and 167 times that of interior region. Over 80 percent of China's gross rural industry exports were made by the nine provinces and the cities of the coast in 1988.<sup>52</sup>

In term of absolute values, in 1982 the value of rural industry output per capita of agricultural population in the coastal region was 109 yuan/person higher than the central region and 138 yuan/person higher than the western region; in 1988 the difference between the two had increased sharply to 2,140 yuan/person and 3,191 yuan/person, respectively, a more than 20 fold increase.<sup>53</sup>

Li Shih Chun's study<sup>54</sup> also showed that regional development imbalances have been very wide. In 1986 the gross value of output from rural enterprises in 8 provinces and cities-Beijing, Tianjin, Shanghai, Liaoning, Shandong,



Jiangsu, Zhejiang, Guangdong-accounted for 50 percent of the gross value of output for rural enterprises nationwide. By contrast, the gross value of output from rural enterprises in 8 northwestern and southwestern provinces, Shaanxi, Gansu, Ningxia, Qinghai, Xinjiang, Guangxi, Guizhou, and Yunnan- accounted for only 5 percent of the gross value of output for rural enterprises nationwide.<sup>55</sup> Furthermore, regional development imbalances have also appeared in different regions of a single province. For example, the gross value of output from rural enterprises in Suzhou, Wuxi, and Changzhou-three southern Jiangsu cities near Shanghai accounted for 50 per cent of gross value of output for the entire Jiangsu Province in 1986. By contrast, rural enterprises in Xuzhou, Huaiyin, Yancheng, and Lianyung--four cities in northern Jiangsu-accounted for only 11 percent.<sup>56</sup>

The unbalanced development of rural enterprises has widened the regional income differential since farmers' income from rural enterprises has become the main source for farmers' income increase. For example, between 1982 and 1988 income supplied by the rural industry of developed coastal provinces and cities to each person in the rural areas increased from 27 yuan to 200 yuan, while that of the central and western undeveloped region increased from only 2-5 yuan to 9-27 yuan.<sup>57</sup> Thus, the gap between China's east and west in terms of production and living standards in rural areas has widened. Since the imbalance development of rural enterprises between China's coastal and interior

provinces is continuing to expand, it will be impossible for the farmers in the central and western interior regions to expect to narrow the income gap with the coastal regions. This could result in social tension.

Although most rural enterprises are distributed in coastal provinces and economically developed areas, the majority of rural enterprises are located in townships and villages. Surveys estimated that only 12 percent of China's rural enterprises in 1985 were distributed in market towns, barely 1 percent in cities above the county level, and more than five-sixths in townships and villages.<sup>58</sup> This spatial distribution of rural enterprises has caused much economic inefficiency. First, rural enterprises take up too much land, which is costly. Second, as the enterprises are constructed in a dispersed manner, their infrastructure cannot be provided in a unified basis. Almost every enterprise has its own set of facilities for delivery and conversion of electricity, water supply, transportation, and communication. This occupies excessive fixed assets but with a low utilization rate. Third, the dispersed distribution of enterprises in the countryside has hampered the transportation of goods and materials, information transmission, and funds settlement, leading to higher costs and slower responses to the market. Furthermore, it has hampered the integration of enterprises. And the linkage between the enterprises and the city as well as the market is particularly impeded, which makes management and

integration of the market as well as the introduction of technology very difficult. Finally, although locating enterprises in the countryside makes it convenient for peasants to have part time farming, it is unfavorable for the improvement of the quality of the enterprises' staff and workers and for pollution control.

### **5.2.2 Implications of Regional Development Strategies for Rural Enterprises**

Dali Yang demonstrated that there has been a significant change of China's regional development strategy since 1978. During the 1953-78 period, China's regional development strategy emphasized regional industrial balance and sought to correct the inherited coast-interior imbalance by directing a large portion of industrial investment into inland area.<sup>59</sup> Since 1978 China's leaders adopted the "uneven development strategy", which focuses on economic results, and emphasizes regional comparative advantage, accepts regional disparities as inevitable, encourages foreign investment and international interaction, and seeks to foster technological innovation.<sup>60</sup> China's government has increased investment of fixed assets in coastal areas since the late 1970s. For example, in early 1980s the coastal region accounted for about half of all central government investment.<sup>61</sup> A series of preferential policies have been granted to the coastal region, enabling it to attract most



of foreign investment. For example, China made use of over US\$5 billion in foreign investment by 1987. Most of that investment went into the coastal region, with Guangdong alone hosting over 65 per cent of all foreign investment enterprises in China.<sup>62</sup> In addition, the favourable policies were granted to coastal areas and especially the Special Economic Zones. As a result, rural enterprises in the coastal region enjoy vast advantages in their dealing with other provinces and they have more business opportunities to cooperate with state enterprises and foreign enterprises.

Since 1978, China's government has given not only preferential financial treatments but also tax relief for rural enterprises in poor areas so that these policies could bring these areas out of poverty (by Chinese standards: per capita annual income 200 yuan). However, Dali Yang demonstrated that the centre's policy towards the poor areas has been undermined by three factors: first, China has seen the decentralization of economic decision-making powers from the centre to lower levels since 1978. This has resulted in increased revenue retained by lower administrative levels. Government and party administrative expenditures are higher in poor areas than in more developed areas. These poor areas have less funds left for the development of rural enterprises.<sup>63</sup> Bank deposits in the poor areas prefer to invest in the more developed central and coastal regions since the intervention by multi-tier, low quality, and overstaffed governments and a host of

geographical, cultural and social factors reduced returns on investments and frighten potential investors away.<sup>64</sup> Finally, poorer conditions in the underdeveloped area have made it difficult to attract and keep talented personnel, thereby making development even more difficulty.<sup>65</sup> Thus, although China's government has implemented some policies to develop rural enterprises in the poor areas in the 1980s, the Chinese government's ability to alleviate regional development imbalances of rural enterprises is limited.

The uneven development of the economy and comparative advantages were another reason for development imbalances of rural enterprises. Shuan Breslin<sup>66</sup> has demonstrated that uneven development and comparative advantage not only exists between provinces, but also within provincial boundaries. In particular, municipalities with high economic status have massive comparative advantages over the rest of their provinces.

The coastal regions have enjoyed superior factor endowments compared with the interior. Coastal regions possess an industrial labour force with long years of experience, and also accumulated superior managerial skills compared with the interior. Coastal areas such as Jiangsu, Zhejiang, and other economically developed areas have more technological personnel than interior areas. Hence, coastal areas can also provide more assistance for rural enterprises in terms of technological personnel. The fundamental economic advantage of poorer, more backward areas is their

low wage rates. However, capital and entrepreneurs are largely immobile and are not attracted to poor areas. As a result, the advantage of low wage rates in the interior is of limited use.

The development of rural enterprises is contingent upon the availability of urban markets. A developed urban economy can provide its surrounding rural area with vast quantities of timely economic information, which in turn stimulates growth of the rural market economy. A developed urban economy with substantial demand for products from rural enterprises undoubtedly stimulates rapid growth of rural enterprises.

### **5.2.3 Summary**

Since 1978, regional development imbalances of rural enterprises have widened. Rural enterprises are highly concentrated in the coastal provinces and the municipalities of Beijing, Tianjin, and Shanghai, but very undeveloped in the broad interior regions of central plain and western China. The development imbalances of rural enterprises have also widened regional income differentials. China's regional development strategy and comparative advantages in coastal areas are the main reason of regional development imbalances of rural enterprises.



### 5.3 Conclusion

The government has been incapable of solving the problem of rural surplus labour, and was forced to let localities deal with the problem of rural underemployment. The urbanization which accompanies industrialization creates problems for most developing countries: millions of impoverished farmers have crowded cities beyond capacity, and many cities are plagued by slums, vagrants, high crime rates, and other urban ailments. The development of China's rural enterprises however provides an exception. The growth of rural enterprises has provided a local solution to the problem of rural surplus labour. China's experience has shown that in shifting rural surplus labour toward the development of rural enterprises, not only has this avoided large-scale shifts in rural population, but it has also avoided a decline and dissolution of the countryside. The development of rural enterprises has recently quickened its pace, and traditional agricultural areas have reaped considerable benefits as a result.

From a short-term perspective, there will not be a dismantling of the barriers between the cities and the countryside, nor will there be much greater freedom of population migration. The current household registration system will still remain as a barrier to the migration of peasants to large cities. Chinese peasants do not have the

opportunity to change their household registration into a non-agricultural one because of this system. This system impedes economic development and social justice, and has many other negative impacts on Chinese society, but it is very difficult to reform. "Attempts to reform certain components of urban privileges such as the housing rents have failed till now. A gradual erosion of these privileges will take decades while a sudden abolition could cause political unrest."<sup>67</sup> Therefore, following the increase in population pressure and the decline of the land for agriculture, the development of rural enterprises will still be China's main strategy for resolving the problem of the surplus population in China's countryside.

Moreover, in the future, the transformation of rural surplus labours will still concentrate on small towns. As I have discussed above, the development of small towns has many social and economic advantages. "China has decided to check the expansion of cities with over half a million people. Cities with fewer than 500,000 people will be developed rationally and the development of small towns with less than 200,000 residents will be encouraged."<sup>68</sup> In particular, the focus will still be placed on the development of county seats and small towns within county boundaries. At the same time, rural enterprises would be encouraged to gather at small towns. However, the main factor restricting the movement of rural population to small towns is the current land system, which serves as a

guarantee of peasants' production as well as a guarantee of social security. It will be necessary in the long distant future that a pension system will be introduced in rural enterprises and together with new social security mechanisms, this will replace the social security presently provided by the land.

It is essential for China's government to take further measures to reduce the regional development imbalances of rural enterprises. Wang Tuoyu<sup>69</sup> provided some suggestions for reducing regional development imbalances of rural enterprises in the future: free interregional flow of labor and of other factors of production should be encouraged; private enterprises should be allowed to develop further; and limited amount of state support available for the more backward areas should be targeted at sound investment projects and at areas with low per capita incomes and poorer agricultural resources.

However, due to the restrictions of the market and funds and limitation of technological personnel in the vast central and western region, the development of rural enterprises will still be limited. Moreover, the possibilities for redistributing resources to the underdeveloped region are limited. Therefore, regional development imbalances of rural enterprises may become worse in the foreseeable future.

In addition, it is necessary to create favourable conditions for reasonable spatial concentrations of rural



enterprises. As I have discussed in the first section, China's small towns have developed very rapidly. Through planning of industrial districts or zones, constructing infrastructures such as roads, electricity and water supplies, facilities for communication and environmental protection, rural enterprises could further be concentrated in small towns.

Since 1978, the government has provided more preferential financial and taxation policies for rural enterprises. Thus, in the next chapter, I will discuss China's government financial and taxation policies for rural enterprises.

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3. "Facts and Figures: Geographical Distribution, Density and National Growth Rate of China's Population," *Beijing Review*, December 17-23, 1990, p.22.
4. Jeffrey R. Taylor, "Rural Employment Trends and the Legacy of Surplus Labour, 1978-86," *The China Quarterly*, Number 116, December 1988.
5. *ibid.*
6. *ibid.*
7. The "experience method" is rural production team leaders would estimate average labour requirements for the production work of their villages, and simply compare these estimates with actual labour hours to derive labour statics. See in Jeffrey R. Taylor, *op.cit.*
8. The "estimation method" is calculated by first determining over all labour requirements for a benchmark year, and then comparing this with actual labour use. See in Jeffrey R. Taylor, *op.cit.*
9. The "labour norm method" is determined by the first calculating overall labour requirements, obtained by dividing the sum of labour days required to grow individual crops by the average annual labour days available per worker. This quotient is then subtracted from the actual rural labour force to yield an estimate of redundant workers. See in Jeffrey R. Taylor, *op.cit.*
10. Jeffrey R. Taylor, *op.cit.*
11. March 2, *Economic Daily (Jingji Ribao)*.
12. "Sons of the Soil," *The Economist*, June 22nd 1991
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15. Thomas G. Rawski, *Economic Growth and Employment in China*, Oxford University Press, 1979, pp. 194. Jeffrey R. Taylor,
16. Jeffrey R. Taylor, *op.cit.*
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19. *ibid.*
20. *ibid.*
21. Li Shihui, *op.cit.*
22. Feng Lanrui and Jiang Weiyu, *op.cit.*

23. The State Council recently approved and transmitted the "Report on Creating a new situation for Commune and Brigade Enterprises," by the Minister of Agriculture, Animal Husbandry and Fishery and the ministry's leading Party group, in March, 1984.
24. *ibid.*
25. Fei Xiaotong have intensively published many articles in the different Chinese journals. For example, Fei Xiaotong, "China's Road to Rural Industrialization," *Beijing Review*, No.14, April 8, 1985.
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## **Chapter 6    Financial and Taxation Policies towards Rural Enterprises**

In Chapter Five, I have discussed China's government rural employment strategies and regional development strategies and their implications for rural enterprises. In this chapter, I will examine the government financial and taxation policies towards rural enterprises. I will analyze these policies under the following headings. First I will examine the state's financial policy towards rural enterprises and its implications. Secondly I will discuss the state's tax policy towards rural enterprises. Thirdly I will consider the sources of capital in rural enterprises. Fourthly I will examine the fundraising methods in rural enterprises. Finally I will analyze future prospects of finance in rural enterprise.

### **6.1    Financial Policy towards Rural Enterprises**

It is estimated that 80 percent of rural enterprises depend to a greater or lesser extent on bank loans. Roughly 20 percent of rural enterprises depend entirely on bank loans to run their businesses. Among the entire nation's rural enterprises, operating fund loans account for approximately 50 percent of total operating funds, and for an even higher percentage of fixed capital.<sup>1</sup> Therefore,

financial policy towards rural enterprises is a very important factor which determines the extent of the development of rural enterprises.

Since 1978, the policy of granting credit to rural enterprises has been more liberal than before, but credit fund supply has been changeable.

**Table 6.1. Credit Growth of Township and Village Enterprises from Bank and Credit Cooperative Credit (%)**

Year	1980	1981	1982	1983	1984	1985
	87.3	21.5	19.6	22.6	108.9	20.4

Source: Wang Xingchun, *Nongye Jingji Wenti (Problems of Agricultural Economy)*, No.23, October 1991, pp.20-25.

(Continued) Credit Increase of Township and Village Enterprise from Bank and Credit Cooperative Credit (%)

Year	1986	1987	1988	1989	1990
	56.7	28.1	20.1	12.8	21

Source: As above.

Table 6.1 shows that growth of credit supply fluctuated greatly during the period 1980 to 1990. Fluctuations in aggregate credit occurred during three periods: During 1979 to 1984, following several years of rural enterprises readjustment, rural enterprises moved from an early development stage to a stage of rapid development. Credit was tightened during 1981 to the end of 1983, but eased in 1984. During this period, credit issuance peaked twice, the highest peak took place in 1984 when credit increased 108 percent over that of 1983.



Influenced by deflation policies, credit supply fluctuated once again during 1985. Credit supply skidded sharply. The Communist Party Central Committee's document no 1 for 1985 set out ten measures aimed at encouraging a market-oriented rural economy. This document further called for relaxing rural financial policies, raising returns on funds, and encouraging rural credit and insurance business. Local credit cooperatives were allowed to operate independently. The document said that the money they raised would be put at their disposal after they delivered a set amount of reserve funds to the Agricultural Bank of China. The term of loan repayment for equipment purchase was one to five years while for technological transformation of old enterprises, the repayment term was one to three years, and for overhauling of equipment, it was one year. The interest rate on loans was also reduced. The document stated that planning, supply, financial, banking and communications departments at all levels of government should let the township and village enterprises open accounts and given them guidance and support.<sup>2</sup> Thus, credit supply rose greatly in 1986 and 1987.

In the fourth quarter of 1987, however, the State Council handed down instructions to tighten finance and credit in an effort to stabilize currency and product prices, and therefore credit supply was tightened again. This contradiction in central government policy has not been the only occasion since 1978 when later pronouncements and

decrees have conflicted with earlier statements. For enterprise managers trying to adapt to the rigours and demands of a newly emerging market economy, such fluctuations in government policy made the process of planning (even in the short term) extremely difficult.

During late 1988 to 1991, Chinese conservative leadership dominated in China. Credit supply showed a downward trend. In 1989, the increase in credit reached the lowest. Rural enterprises thus faced serious financial difficulty. The information showed that if the growth rate in 1989 for rural enterprises was assumed to be 15 percent, that would demand at least 25 million yuan in operating funds. The state in practice only satisfied a small part of that sum.<sup>3</sup>

The retrenchment policy has particularly hit the expansion of newly opened enterprises. Many of the newly opened enterprises had to rely on bank credit for working capital. Retrenchment policy has caused a considerable proportion of enterprise assets to be left idle. For example, Xinxing Building Materials Plant in Luhe County, Jiangsu, with the help of county townships, had received a loan of 11.5 million yuan to import advanced Italian equipment for the manufacture of various types of newly developed building tiles. In October 1988, the equipment was installed and put into operation. Because of the shortage of funds, materials, and electrical power, in 1989, the three production lines having an annual production capacity of 7.5

million square meters were only able to produce 20-30 thousand square meters. They had not even begun to pay off the interest on their loan itself. A large plant and advanced equipment were idle, therefore creating a vast amount of waste.<sup>4</sup>

The fluctuation in the total credit supply has been attributed to the following political and economic factors. First, as I have demonstrated in Chapter two and Chapter Four, rural enterprise policies have been inconsistent because of the struggle of conservatives and reformists within China's leadership. Some conservative leaders emphasized the development of state enterprises and adopted a policy to definitely incline state enterprises to acquire credit supply, energy and raw materials. In particular, when economic development overheated and market supply became tight, restriction of bank credit was imposed. Second, as Wang Xingchun<sup>5</sup> demonstrated, credit supply was directly influenced by the agricultural harvest. In good harvest years, rural enterprises had a solid base and developed very rapidly. As soon as a lean harvest occurred, credit supply was directed to grain and cotton production. Third, China has only undertaken partial reform of the market. Market mechanism for regulating and controlling the total volume of credit for rural enterprises has not fully been developed. The government mainly depended on the plan to control the supply of credit. Excessive control also resulted in large fluctuations of credit supply.



**Table 6.2 Township and Village Credit and Output Value As a Percentage of National Bank Credit and Social Cross Output Value (%)**

Year	1983	1984	1985	1986	1987	1988	1989	1990
(1)	4.0	6.6	6.0	7.3	7.8	8.0	8.0	8.3
(2)	6.8	13.0	16.6	18.7	20.6	23.5	24.3	25

Source:

Wang Xingchun, *Nongye Jingji Wenti (Problems of Agricultural Economy)*, No.23, October 1991, pp.20-25.

Key:

(1) Township and Village Enterprise Credit as a Percentage of the National Bank Credit Balance

(2) Township and Village Enterprise Gross Output Value as a Percentage of Social Gross Output Value

Table 6.2 shows that township and village enterprise credit as a percentage of all national credit increased 2.1 times between 1983 and 1990; however, during the same period, township and village gross output value as a percentage of total social gross output value increased 3.8 times, much faster than the change in the percentage of credit. In 1990, township and village enterprise gross output value as a percentage of social gross output value reached 25 percent, but township and village enterprise credit only accounted for only 8.3 percent of total national bank credit. Thus, rural enterprises have used relatively little credit input to produce a fairly large value output. This further indicates that the government has still adopted discriminating policy against rural enterprises. Thus, rural enterprises have raised funds from individuals and society. An informal financial market has inevitably appeared to supply the fund requirements of rural enterprises. I will further discuss this issue in section 6.4 of this chapter.

However, despite such disturbance from political and economic factors, financial policy towards rural enterprises was generally more liberal during 1980s than in any previous history. In addition, the government established special funds for supporting rural enterprises. There were two sources of such supporting funds. As one source, rural enterprises were allowed to take 1 percent out of their after-tax profits to be used by the administrative departments for rural enterprises. The other source of funding was the assistance from the financial department allocated for developing rural enterprises. Such funds were distributed through consultations between the local financial departments at various levels and the administrative departments for rural enterprises. The supporting funds were not gratuitous. There was a deadline for using such funds, and when this time period expired, the return of the unused funds was demanded so that they could be used over again on a constant, revolving basis. Accounts of enterprise funds and financial assistance funds were required to be kept by the administrative departments for rural enterprises and by the financial departments concerned respectively.<sup>6</sup>

Loans for rural enterprises are mainly used as circulating capital, and as fixed capital formation, as repaying temporary loans and as meeting the higher prices of raw and semifinished materials, energy, etc. To take 1985 as an example<sup>7</sup>, the uses of loans are mainly as follows:

First, a very large portion of the loans were used as fixed capital. In 1985, the value of fixed assets of enterprises at the township and village levels in the country increased 17 billion yuan.<sup>8</sup>

Second, a large amount of credit was used to help enterprises to repay temporary loans. In 1985, a policy was implemented to tighten credit for township enterprises throughout the country. The enterprises' sales increased 44 percent, fixed assets increased 59 percent, and self-generated circulating funds increased 53 percent. Credit extended to them as circulating funds increased only 4.8 billion yuan, or 22 percent. To keep production and business operations going, rural enterprises, particularly those operating on a regular basis, were forced to raise funds by delaying wage payments or defaulting on loans. In 1985, rural enterprises owed workers and staff members more than 2 billion yuan in back wages and defaulted on payments for goods totalling some 5 billion yuan. They had to borrow nearly 3 billion yuan from units and individuals. Most of these temporary loans were repaid out of their sales receipts to buy raw and semifinished materials. According to typical case surveys and national accounting analysis, about 5 billion yuan, or 38 percent, of the increased 1986 credit was used to repay the temporary loans raised by the enterprises in 1985.<sup>9</sup>

Third, more loans were extended owing to market factors. Bank loans increased to meet the higher prices of



raw and semifinished materials, energy, etc. According to typical cases studied, about 20 percent of the credit increase was caused by price rises. For example, the purchasing price of fresh tea leaves rose about 30 percent, and the prices of feed and raw materials rose nearly 50 percent. Owing to the state's strict control over the scale of investment in fixed assets and other reasons in 1985, the building materials, machinery, and electrical industries were faced with a temporary overstocking of products, which also increased their needs for credit.<sup>10</sup>

Thus, we can see that the policy of granting credit to rural enterprises was considerably liberalised during the 1980s. The more open access to the state's investment funds clearly created a more favourable environment for the development of rural enterprises. However, the evolution of a freer credit system was far from unproblematic. The 1980s saw relatively wide fluctuations in credit supply policy. Although access to investment capital was relatively easy at times, macro-economic retrenchment occurred on a number of occasions, and credit supply was reined in. During these periods of credit retraction, rural enterprises were particularly hard hit and found their access to funds severely reduced. In times of difficulty, the state returned to its discriminatory policies towards rural enterprises, instead favouring the more easily controllable state-owned sector. Rural enterprise managers were thus unable to plan with any confidence that existing credit supply arrangements

would stay in place, a factor which obstructed the even greater development of rural enterprises during this period.

## 6.2 Taxation Policy towards Rural Enterprises

In general, tax policy instruments were used to encourage the growth of collective rural enterprises. The rates of tax paid by the collective sector of rural enterprises have relatively been low. For example, in 1966, the rate of industrial and commercial income tax for commune- and brigade- run enterprises was 20 percent and the starting point of the levy was 600 yuan.<sup>11</sup> In 1979, the starting point was raised to 3,000 yuan. Difficult enterprises run by communes and brigades in old revolutionary bases, minority-inhabited areas, and border areas were allowed to enjoy tax reduction or remission for 5 years from 1979. If newly established rural enterprises run by communes or brigades had difficulties in their business operations in the initial stage, they were allowed to enjoy tax reduction or remission for 2 or 3 years.<sup>12</sup> Thus, the rate of industrial and commercial income tax for commune- and brigade- run enterprises was considerably low.

The state council promulgated some regulations concerning the readjustment of industrial and commercial taxes on enterprises run by rural communes and brigades and they became effective on 1st April, 1981.<sup>13</sup> By this provision, taxes might be continuously reduced or exempted.

In some cases this was designed to encourage the development of production by commune and brigade-run enterprises; for example, products directly serving agricultural production such as chemical fertilizers and pesticides and manufacturing or repairing farm implements. Rural enterprises were also allowed exemption from tax on their industrial and commercial income for two to three years after they were set up.

In 1984 the taxation system was further adjusted. The "Provisions on readjusting industrial and commercial tax rates on rural enterprises run by townships and villages on grass-roots supply and marketing cooperatives" were put into effect from 1st January, 1984.<sup>14</sup> These provisions include the following main points:

As of 1982, the 20 percent proportional tax rate of the industrial and commercial income tax which rural enterprises paid was gradually changed to the eight-grade progressive tax rate.<sup>15</sup> The eight-grade progressive tax rate was implemented in 1982 only on rural enterprises in the suburbs and small towns under county jurisdiction which produced 20 products, including cigarettes, wine and sugar. Only by 1984 was this extended.<sup>16</sup> The purpose of this change was to address the unbalanced development of rural enterprises as well as to legislate a rational tax burden.<sup>17</sup> Industrial and commercial income taxes were levied on all rural enterprises run by communes and brigades according to the eight-grade progressive rates with



specified minimum rates. The proportional tax rate of 20 percent was repealed.<sup>18</sup>

The eight-grade progressive tax rate was different from the proportional tax rate, which was suitable for an enterprise with a smaller income. Correspondingly, a higher tax rate was imposed on an enterprise with a higher income. Thus, taxation corresponds to the profit obtained by an enterprise as well as its ability to shoulder the tax burden. This produced some shift of the tax burden to those enterprises with greater profits and those localities where rural enterprises had developed relatively rapidly together with some shift of the tax burden from those enterprises with smaller profits and localities where rural enterprises had developed relatively slowly. However, in overall terms, the change in the tax burden of rural enterprises was slight.<sup>19</sup>

In 1978, rural enterprise profits totalled 9.55 billion yuan, with 640 million yuan of income tax. The effective rate of tax burden was 6.7 percent.<sup>20</sup> In 1983, the state used the eight-grade progressive tax rate to configure the income tax for rural enterprises in the suburbs of large cities and small towns under county jurisdiction. Although the actual burden had increased to 11.49 percent, compared with 38.13 percent for the collective enterprises under urban No 2 light industrial system in 1983, this burden was still light.<sup>21</sup>

However, tax policy towards rural enterprises was ambiguous. For example, as for some special enterprises which needed further tax reductions or remissions, local governments in various provinces, autonomous regions and municipalities could handle their cases according to the following provisions: First, if newly established rural enterprises run by townships or villages had difficulties in their business operations in the initial stage, they could be given a year tax grace period; Second, if enterprises which engaged in the primary processing of agricultural products, small-scale hydraulic or thermal power generation, or mining industry found it difficult to pay industrial and commercial taxes. Reduced taxes could be imposed on them within a set period.<sup>22</sup> In addition, when townships and villages were hit by natural disasters, industrial and commercial income taxes on rural enterprises could be reduced or remitted within a certain period. Difficult enterprises run by townships and villages in old revolutionary bases, minority-inhabited areas, and border areas were allowed to enjoy tax reduction or remission.<sup>23</sup>

Therefore, some local governments have used this ambiguity in taxation policy to develop their own strategies towards rural enterprises. They have unilaterally reduced and even exempted income tax on rural enterprises if this measure best suits their own local fiscal interest. My own observations of the situation in Zhejiang Province confirms that this practice was widely spread in some counties.

After the issuance in April 1985 of the Provisional Income Tax Regulations Governing Collective Enterprises, a new system of eight-grade progressive taxation was adopted for all collective enterprises.<sup>24</sup> Under the new system the lowest grade is 1,000 yuan, the tax rate on which is 10 percent, and the highest grade is 200,000 yuan, the tax rate on which is 55 percent. Newly established township and town enterprises are exempted from paying income tax during a fixed period. Some enterprises which still experience difficulties after the expiration of the term may continue to enjoy tax exemption or reduction during another fixed period. Spending by a township and town enterprise on public welfare may be listed as expenditure and is entitled to tax exemption, but the total amount is limited to only 10 percent of its total profit.<sup>25</sup>

Therefore, from the above detail it is clear that the state has adopted preferential tax policies with tax reduction or tax exemption measures for collective rural enterprises (township and village run enterprises). This has undoubtedly played a positive role in the development of rural enterprise. However, tax rates for collective rural enterprises have gradually increased. There have been other tax regulations which have discriminated against rural enterprises. For example, no reduction and remission of industrial and commercial income taxes have been allowed for rural enterprises and other enterprises which competed with large-scale industrial enterprises for raw materials. Thus,



on the one hand, local governments have exercised the power to reduce and even exempt from income tax on rural enterprises for local interests, whilst on the other, the shortage of fiscal income in local communities and local government funds for welfare work and agricultural funds has also led to the problem of local government exacting a large percentage of profit, collecting excessive charges. I will analyze this issue in section 7.2.2 of Chapter Seven.

Moreover, China's taxation system has worked in accordance with a commercial ownership type of tax appraisal and collection system, and favours state owned and collectively owned enterprises over private enterprises. Before June 1988 state owned enterprise fitted into the 55 percent tax rate bracket. Collective enterprises were adjusted at eight-grade progressive tax bracket where the highest tax rate was only 55 percent. Individual industrial and commercial firms along with private enterprises have been placed in the tenth grade of progressive tax rates where the highest actual tax rate can be up to 84 percent. This progressive tax system, administered to the individual industrial and commercial enterprise established in the 1950's was enacted in order to restrict and reform these two sections. This tax system had the following effects: First large numbers of private enterprises committed tax evasion. According to a survey conducted by the State Tax Bureau, more than 80 percent of all individually owned industrial and commercial businesses were guilty of tax evasion. In

1988, taxes worth 7 billion yuan were collected from such businesses; but it was estimated that an equal amount was not paid.<sup>26</sup> "One informant, engaged in conducting surveys on Shanghai's self-employed, stated that:

"official tax rates, as well as local "fees" are often calculated at artificially high levels since the expectation is that everyone is underreporting. Therefore, those who are completely honest will find it difficult to remain in business. Self-employed businessmen of necessity commonly raise prices -- seeming arbitrarily -- to cover these costs."<sup>27</sup>

Thus, falsified tax returns could be regarded as a part of a systemic flaw rather than as criminal intent on the part of the entrepreneurs. Secondly, faced with mounting tax bills, some private enterprises found it more profitable to reduce production and seek to re-register as "individually owned enterprises" rather than maintain production and pay the higher tax rate. Thus, continuing to use a 1950s policy of levying high taxes eventually hampered development in the private sector.

In June 1988 the State Council published new tax regulations for private enterprises. In the new regulations, private enterprises have to pay 35 percent income tax and to use at least 50 per cent of their after-tax profits for production expansion. A 40 per cent personal income tax is levied on the amount private enterprises spend on personal

living costs.<sup>28</sup> New tax regulations try to offer tax incentives to enterprise expansion and investment of profits. However, private enterprises still suffer from the arbitrary collection of other fees and duties by local government. A private entrepreneur complained that: "At present, I have to pay 11 kinds of taxes and duties such as business tax, income tax, and taxes for education, construction, real estate, land use as well as industrial and commercial consolidated duties. To be frank, I am taxed too much."<sup>29</sup> A number of private enterprises have not been able to bear the burden and have had to close down.

In summary, the extension of preferential fiscal policies towards rural enterprises has been one of the main central policies aimed at facilitating the development of rural enterprises. However, despite initially providing a great help for rural enterprises, taxation rates have gradually increased. Rural enterprises have thus fallen foul of the increasing budgetary pressures on central (and local) government. Although the need to increase state finances is a very real one, it is notable that foreign and joint owned ventures have not been subject to an equivalent degradation of special taxation policies, and the further expansion of the rural enterprise sector has certainly not been aided by this move. Given the massive potential long term benefits that rural enterprises can bring to the Chinese economy (as demonstrated in Chapter One), the reduction of tax benefits marks the triumph of short term considerations over long



term strategy. Indeed, in almost all respects, the development of the rural enterprise sector has been obstructed by short-termism in central government policy making.

Furthermore, although the collective sector has done relatively well from preferential taxation policy, private enterprises are actually penalised by the fiscal system, paying very high taxation rates. This uneven policy has had two major affects. Firstly, the expansion of the private sector has obviously been obstructed. Secondly, many private enterprises have officially registered as collective or individually owned. Such an illicit registration is dependent on the collusion of local government officials, which rather than drawing attention to the extent of official corruption in post-Mao China perhaps instead indicates that local cadres are more aware of the need to develop this sector than their central government superiors.

### **6.3 Sources of Initial Capital of Rural Enterprises**

In William A.Byrd's research, the sources of capital for rural enterprises was divided into three: household capital, community capital, and enterprise capital.<sup>30</sup> Household capital is private funds invested directly in rural enterprises by households. It consists of investment by partners or proprietors, informal loans to private

entrepreneurs, purchase of bonds issued by community enterprises, and provision of capital in return for jobs.<sup>31</sup>

Community capital is investment funds which are determined or strongly influenced by community government, particularly at the township level. This capital consists of local government budgetary funds for rural enterprises investment, loans of fiscal revolving funds to rural enterprises, profits from community enterprises pooled by township or village industrial corporations, and banks and rural credit cooperative loans.<sup>32</sup>

Enterprise capital is the retained profits, depreciation allowances, and other funds of rural enterprises as well as funds provided by other enterprises. Capital from other firms is largely trade credit, of indefinite maturity and highly unstable. The allocation of part of the retained profits and other funds of community enterprises are influenced by the community government, but enterprises may have considerable autonomy in making smaller investments. <sup>33</sup>

In addition, some capital comes from previously existing enterprises such as county industry, later transferred to village and township. As table 6.3 shows, the state accounted for only a small share of the capital requirements.

**Table 6.3. Source of Funds for Large-scale TVPs (percentage of total)**

Source	At founding	End 1984	End 1985	End June 1986
State capital <sup>a</sup>	4.0	1.8	1.6	1.7
Community capital <sup>b</sup>	67.6	35.2	30.1	27.8
Bank loans	38.2	28.9	24.1	23.4
Contributions by community government <sup>c</sup>	29.4	6.3	6.0	4.4
Enterprise capital	13.0	55.8	59.8	63.0
Own funds <sup>b</sup>	0.0	41.0	40.7	43.2
Other firms <sup>d</sup>	13.0	14.8	19.1	19.8
Household capital	7.6	4.2	5.6	4.9
Enterprise's own workers <sup>e</sup>	6.5	3.5	4.6	4.0
Outside individuals	1.1	0.7	1.0	0.9
Unidentified <sup>f</sup>	8.9	3.7	3.9	3.5

Note: Figures for 1985 were adjusted to correct apparent arithmetic errors.

a. Included grants and loans from state agencies.

b. The share of community capital for 1984-86 is understated and that of household capital is overstated somewhat because "own funds" includes nonpayable capital provided by the township government as well as internally accumulated capital.

c. Includes fiscal revolving funds lent to TVPs, which may be to some extent controlled at the country rather than the township level. Grants funds from the community government for 1984-86 are not included.

d. May include some debts owed to government entities, since it includes parables as well as loans and capital investment provided by other enterprises. The bulk of this capital comes from outside the locality.

e. Wages payable to workers and investment contributed by them.

f. For time of founding, other funds; for 1984-86, other long-term debt.

Source:

Zhou Qiren and Hang Zhuangjun(1987), from a sample of 200 relatively large and successful TVPs in ten provinces, see also William A.Byrd,"Entrepreneurship, Capital, and Ownership", in edited by William A.Byrd and Lin Qingsong, *China's Rural Industry--Structure, Development, and Reform*, Oxford University Press, 1990, p.201.



It was very importance for the community to provide initial capital for community enterprises at their founding. The community's share declined as enterprises developed and generated investment funds internally. The role of household capital in financing community enterprises was relatively small.

**Table 6.4. Sources of Increased Investments in Township and Town Enterprises**

Year	1980	1981	1982	1983	(1)
(2)	91.0	72.0	84.0	85.0	332.0
(3)	51.6	59.4	56.7	59.4	56.5
(4)	40.0	23.9	25.0	32.5	30.8
(5)	8.4	16.7	18.3	8.1	12.6
(6)	123.0	139.0	152.0	206.0	

Source:

*Taiyuan Nongye Jingji Xiaoguo* (Agro-Economic Results) in Chinese No 2, 25 Apr 86, pp.8-15.

Key:

- (1) Four-year total and average
- 2 (2) Increase in fixed assets and circulating capital funds (100 million yuan)
- (3) Proportion of the above from increased accumulation in township and town enterprises (percent)
- (4) Proportion from increased loans (percent)
- (5) Proportion from increases in other sources of capital (percent)
- (6) Total amount of loans issued during the year (100 million yuan)

Table 6.4 shows that most of the added sources of investments during 1980-83 for the development of rural enterprises were: an average of about 56.5 percent accumulated within the enterprises themselves, about 30.8 percent from bank and credit cooperative loans and 12.6 percent from other lenders. This indicates that capital accumulated within the enterprises played an important role in source of added investment in rural enterprises, while

the funds from the banks also highly influenced the expansion of rural enterprises.

Over this period, the amount of capital raised by the enterprises themselves basically stayed between 5 and 6 billion yuan and the rate of growth was small, expanding only with township and town enterprises production. About 60 percent of these loans were assistance loans for circulating capital and investments in fixed assets in township and town enterprises.<sup>34</sup> Without this rather substantial assistance, it would have been hard for township and town enterprises to sustain expansion. It is apparent that township and town enterprises depend considerably on loans.

The initial capital for private enterprises comes mainly from the following sources:

First, since 1978 the Chinese government adopted a more liberal financial policy towards private enterprise, and the amount of state loans towards private enterprises have risen. According to two surveys of private rural enterprises, state loans accounted for about 50 percent or 40 percent of the initial capital for private rural enterprises.<sup>35</sup> Thus, state loans are an important source of the initial capital for private enterprises.

Secondly, previously existing poorly managed small scale collective enterprises have been sold or leased to individuals. The capital from these enterprises became one source of capital formation for private enterprises. According to some surveys, leased enterprises in 1984

accounted for 18.6 percent of total private enterprises in Hebei, 30 percent in Tianjin, and 40 percent in Liaoning.<sup>36</sup>

The third source of initial capital for private enterprise is from credits for the purchase of production materials and prepaid funds. This source is very volatile. A survey of 130 private rural enterprises in 18 provinces indicates that this source accounted for more than 50 percent of initial capital in 1984, though it dropped to 20 percent in 1987.

Another important source of initial capital for private enterprise is from individuals and society. I will further discussed this issue in section 6.4 of this chapter.

In conclusion, capital in both collective and private rural enterprises mainly consists of household capital, community capital and enterprise capital. State loans play an important role in the formation of the initial capital for both collective and private rural enterprises. Thus, if the state controls or reduces loans towards rural enterprises, then further development of rural enterprises would inevitably be restrained, and some rural enterprises could even face bankruptcy. The accumulation of individual funds is a less important source of initial capital for collective rural enterprises, but it is a considerable source for private rural enterprises.



#### 6.4 Fundraising for Rural Enterprises

The rise of rural enterprises has increased demand for capital. Capital determines the pace and scale of the development of rural enterprises, while at the same time the development of rural enterprises has affected the circulation of rural capital.

For many years, the development of rural enterprises has relied on community capital, or accumulated capital by the enterprises themselves. However, particularly late 1980s, owing to the rapid growth of rural economy, funds from these channels have fallen far short of demands. For example, the 1985 plans of Jinzhong Prefecture, Shanxi Province, called for the establishment of 7,429 new township and town enterprises of various kinds and the technical transformation of 718 enterprises to increase their production capacities, requiring a total of 246.76 million yuan. However, banks and credit cooperatives could provide only 68.32 million yuan in loans, meeting only 27.8 percent of the amount needed, and sufficient capital was not available for most of the planned new enterprises.<sup>37</sup> Thus investment funds saved by individuals had become an alternative means of meeting the shortage of capital.

When the state adopted measures to tighten the financial market and placed stricter and stronger controls on loans to rural enterprises, in particular, during late 1988 to

1991, rural enterprises have encountered serious capital shortage problems in their development. Therefore, fundraising for rural enterprises has become more important.

Local party and government leaders are concerned about the effects of tight credit on the development of rural enterprises which affects rural employment and income and tax revenues generated by increased output and in turn affects local economic development. The objective of enterprise growth includes assuming responsibility for employing the residents of their own community, and also for various rural undertakings, including cadre compensation. To realize these tasks, enterprises can be given large concessions with respect to profits retention. When enterprises are confronted with serious financial difficulties, local governments will do all they can to support and protect them.

After the implementation of the production responsibility system in Chinese rural areas, the income of Chinese farmers has considerably increased. With the development of the specialized households, in particular, some rich specialized households accumulated several thousand or even tens of thousands of yuan in saving deposits. Total saving deposits in urban and rural areas increased from 21,060 million yuan in 1978 to 307,330 million yuan in 1987.<sup>38</sup>

One reason was a shift from the collective to peasants' material accumulation in the countryside. Until

the end of the 1970's, accumulation in the countryside relies heavily on the collective as a source of capital, equipment and raw materials. Eloquent proof is provided by the following: of the total agricultural output value in 1979, output value of collectively owned enterprises accounted for 79.2 percent and that of household sideline occupations only 17 percent.<sup>39</sup> After the early 1980's, peasants' personal deposits in credit cooperatives grew at an extremely quick pace, while collective deposits dropped from year to year. In 1985, the peasants personally received in total more than 190 billion yuan, accounting for over 90 percent of net agricultural income. The collective received only 8-plus billion yuan, accounting for 4 percent of net agricultural income.<sup>40</sup> The investment funds raised by individuals had become available in significant amounts for rural enterprises.

Since late 1980s, rural areas throughout China have developed various capital raising activities for rural enterprises development. This has alleviated the capital shortage to a certain degree. For example, various places have permitted people with either capital or labour to enter the enterprises, investing in shares, importing outside capital i.e capital from another area of China or even from foreign countries. In addition, the enterprises can be made more efficient internally in ways like dealing with material overstocks as quickly as possible and pressing for repayment of loans in order to transform unused capital into active



capital. During the process of capital raising in rural areas across China, both economic and administrative measures have been employed to mobilize the funds. To take the example of rural Jinzhong Prefecture, Shanxi Province, Liu Zhihong<sup>41</sup> demonstrated that the peasants' funds have been mobilized for town and township enterprises mainly in the following five ways:

The first way of fundraising is from loans. These may be divided into several types. The first type of loan is interest-free. Generally this occurs when an individual household, planning to start a small business, borrows money from relatives, friends, and neighbours. As they trust each other, and only small amounts of money are involved, the loans are interest-free. The second type is low-interest loans. Investors earn interest on their money according to current bank loan interest rates. A common practice is the formation of a fundraising company with limited liability by related enterprises, units and individuals. The company issues shares and engages in credit and loan business. The enterprises, units, and individuals put their money in the company and become shareholders. The principal and interest of shares are guaranteed, but there is no distribution of bonuses or dividends. Those who apply for loans from the company must sign contracts. Shares have a longer time limit than loan contracts. Share interest rates should be higher than savings deposits. Units and individuals receiving loans pay interest rates which should be higher than deposit

rates. Units and individuals receiving loans pay interest at current loan interest rates. The third type of loan is the market interest rates loan. A trust and investment company is formed to accept deposits and extend loans at negotiated interest rates.

The second way of fundraising is labour-investors. An enterprise may combine labour recruitment with fundraising. Each worker hired is requested to invest a fixed amount of money in the enterprise. When a worker quits working for the enterprise, his money is paid back to him in full. Shares earn money in one of three ways: First, a certain proportion of the enterprise's after-tax profit is distributed as dividend among shareholders and workers. Generally a bigger portion is distributed for work than for shares. Second, the enterprise pays both interest and dividend. The interest rate is equal to or slightly higher than the bank rate. The investors are guaranteed interest payments, and the amount of dividends is tied to the enterprise's performance. Third, investors receive only interest and no dividend. The enterprise pays interest to the investors on a monthly or quarterly basis as stipulated in the contracts.

The third way of fundraising is joint ventures. Under this form of fundraising, investors take part in enterprise management. They share the capital investment, management, profits and losses. Joint ventures can be based on three kinds of economic ties. First, joint ventures between one household and another, combining labour with skills and

pooling financial resources. Second, joint ventures between one village and another, pooling financial, labour, and natural resources, breaking through the regional economic barriers formed by the administrative divisions. This leads to the horizontal flows of funds, technology, and labour between regions. Third, joint ventures between township and village enterprises and state-owned industrial and commercial enterprises, breaking through the barriers between different ownership systems and between urban and rural economies. This leads to the establishment of vertical urban-rural economic linkages. Finally, combined agricultural-industrial-commercial operations further expand economic contacts between urban and rural areas and promote integrated agricultural, industrial and commercial development in rural China.

The fourth way of fundraising is dividend-earning shares. This method is often used by enterprises which require relatively large capital investment. As the main objective of this type of investment is to earn dividends, investors generally do not participate in management. To guarantee investors' economic benefits and encourage the peasants to buy shares, most enterprises not only guarantee interest payments, but promise dividend distributions. The interest rates may be lower than bank deposits interest rates, and dividends are determined by negotiation.

The fifth way of fundraising is capital from elsewhere. Funds brought from other places play an important part in



accelerating the development of township and village enterprises. As production grows, so will the attraction to investment capital from elsewhere. Funds may come from other regions and provinces. Overseas Chinese and foreign capital can also be used. In actual practice, the following three forms are most commonly used by town and township enterprises. First, compensation trade: machinery, equipment, production technology and so forth are bought on credit. Loans are repaid with products or other commodities after the start of production. Second, rural enterprises provide the natural resources, plant sites, labour, and so forth; and funds, technology, equipment, and so forth are provided by investors from other places. Third, various credit organizations, such as fundraising companies, and credit forms, such as bond issues, selling on credit, commercial notes, commission shops, leases, etc., have appeared among the peasants in rural areas. Examples include some counties that have established specialized organs to raise capital in rural areas, convened various types of conferences, organized mobilizations, assigned capital raising tasks according to villages and set time limits for their completion.

Fundraising for rural enterprises in rural areas has alleviated the shortage of funds. However, in some places local governments use administrative measures to force farmers to raise funds for rural enterprises. As a result, there have been negative outcomes. First, this has caused

blind action in township and village enterprises construction projects and resulted in half-completed projects. Many enterprises fail to make plans when they get underway and go into operation as soon as they raise a little capital. They place their hopes for a solution to their capital needs on the flexibility of bank credit and financial investments. Second, because capital collection is assisted by administrative measures, whoever you are poor or rich, you have to participate grudgingly in raising capital. Thus, some of the peasants are not happy with this way.

### 6.5 Conclusion

Since 1978, China has used diversification as the strategic principle to develop its agricultural economy. Rural enterprises were considered as an important component of a diversified economy, and an important source of state revenue. The government has provided more favourable tax and financial treatment for rural enterprises. As a result, financial and tax policies have provided more favourable financial condition for the development of rural enterprises.

However, tax rates for rural enterprises have gradually increased. China's taxation system has still favoured collectively owned rural enterprises over private rural enterprises. In particular, credit supply fluctuated greatly

during 1980s. As a result, this has greatly affected the development of rural enterprises. In particular, during late 1988 to 1991, a retrenchment policy has been implemented, the government has reduced loans for rural enterprises, and stopped granting loans to small textile mills, woollen mills, oil refineries, aluminium works, cigarette factories and distilleries.<sup>42</sup> Tightening financial policy has produced serious financial difficulty for rural enterprises.

Therefore, fundraising by rural enterprises has become an alternative option. The experience during late 1988 to 1991 has shown that rural enterprises will still survive in situation of financial difficulty. Nan Bei<sup>43</sup> indicated that: "the rising tide of fundraising enables us to state one thing without doubt: rural enterprises born amidst the market mechanism have learned to depend on themselves to survive difficulties and crises." Thus, although the government financial policy will affect the extent of the development of rural enterprises, rural enterprises have an ability to survive and overcome the shortage of funds. With the reform of the financial system, rural enterprises will have more opportunities to obtain funds by different methods.

Moreover, although one third of industrial output value come from rural enterprises in 1991, state industrial loans towards rural enterprises accounted for only 2.5 percent of total state industrial loans.<sup>44</sup> Ironically, nearly two thirds of state enterprises are still running at



a loss. Recently, statements in favour of further promotion of rural enterprises are by far exceeding critical statements. Moreover, local governments have put great pressure on central government to relax credit towards rural enterprises. As a result, state loans towards rural enterprises are expected to increase again.

However, since rural enterprises are developing very rapidly, rural enterprises will demand huge funds. Therefore, it is necessary to improve the use of loans in rural enterprises, and rural enterprises should take various measures to solve the shortage of funds. The banks should protect or restrain the growth of various categories of enterprises through readjustment of the credit structure. The enterprises which are efficient and have a rapid turnover of funds should be actively supported by the bank. The enterprises which are inefficient and have a slow turnover of funds and poor sales of their products should be cut back or have financial support terminated. Rural enterprises could develop more joint-household enterprises by taking advantage of the funds collected by the multitude of peasant households and opening rural financial markets, so that idle social capital can be reasonably developed and used.

Since 1978, China has adopted some policies to improve management in rural enterprises. In the next chapter, I will discuss how these government policies influence management in rural enterprises.

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## Chapter 7 Government Policies to Improve Management in Rural Enterprises

In Chapter Six, I have discussed government financial and taxation policies for rural enterprises. In this chapter, I will examine the effects of government policy on the management of rural enterprises. It is not a secret that many problems in the management of rural enterprises not only exist but are very serious. In general, management skills in rural enterprises are rather low. Very few of the management cadres now working in the enterprises have an upper middle school education.<sup>1</sup> Every year many rural enterprises drop out of market competition and go bankrupt or close, and although there are many reasons for this, one of the main reasons is poor management. Therefore, the management of rural enterprises is an important issue. However, the issue of management is a very broad one. In this chapter, I will mainly concentrate on analyzing local government's role in the management of rural enterprises and the way in which some government policies influenced the management of rural enterprises. In doing so, first, I will examine the administrative management exercised by township and village governments. Secondly, I will deal with some government policies towards income distribution in rural enterprises. Thirdly, I will analyze the government policy of promoting the quality of production in rural enterprises.

Finally, I will draw some conclusions and make some suggestions for the improvement of management in rural enterprises. The research on this issue by Byrd and Gelb is a distinguished and pathfinding work, and as such provides the framework for analysis in this chapter.

### **7.1 Administrative Management Systems of Rural Enterprises**

The owners of state enterprises belong to all the people. The owners of rural enterprise can be divided into two general categories: town and village governments, and private entrepreneurs. In the state-run enterprises the responsibility for the profits of the assets as well as for risks for the investment of the enterprises is unclear. The loss in state enterprises is often ultimately shifted to the whole of society. However, rural enterprises bear more clear responsibility for the profits of their assets and for the risks involved. The profits and risks of the assets of rural enterprises, especially the investment risks, have to be borne by the members of the villages, townships or individuals.

Since the ownership structures in rural enterprises are different, their administrative management structures also take on different forms. For example, the assets in private rural enterprises belong to private entrepreneurs, accordingly township and village governments have only

indirect control over their management structure. I will analyze this structure later. By contrast, in traditional collective rural enterprises, township and village governments share in both rights of ownership and administrative management. Fiscal revenues of township and village come largely from rural enterprises in the form of profit remittances and management fees. The profit handed over by township enterprises in the sample counties constituted more than 38 percent of township government revenues, while remittances by township enterprises accounted for 43.6 percent of township revenues and tax payments by enterprises under other forms of township for 14.3 percent.<sup>2</sup> Therefore, the income from rural enterprises is a very important source of fiscal revenue of township and village government.

In addition, township and village leaders have personal financial incentives to develop rural enterprises. William A. Byrd and Alan Gelb's research<sup>3</sup> has demonstrated that personal benefits for township and village leaders are associated with rural enterprise development. First, Community leaders' pay varied significantly with the degree of TVP (township, village, private enterprises) development in the community, and this variation was greater for villages and production teams than for townships and towns.<sup>4</sup> Secondly, in the more developed areas of rural enterprises more funds were available for consumption of community government or enterprise resources from cigarettes to



banquets to housing construction.<sup>5</sup> Thus, undoubtedly these personal benefits are another incentive for township and village leaders to promote the development of rural enterprises. Thirdly, as I have demonstrated in Chapter Three, there was a variation of personal financial incentives.

Therefore, the development of rural enterprises, especially collective rural enterprises, is very important for the fiscal incomes of township and village governments as well as for the personal incomes and rewards and career prospects of village and township government leaders. William A. Byrd and Alan Gelb pointed out that "Despite the variation in personal incentives for community government leaders among regions and localities and among community levels, it is clear that everywhere and under almost any circumstance community government leaders have strong incentives to develop the TVP sector (township, village, and private enterprise)."<sup>6</sup>

Township and village governments have actively aided and supported township enterprises in finance, marketing and technology. Of the township governments surveyed<sup>7</sup>, 73.0 percent have helped enterprises resolve problems with finances, 49.2 percent have opened a variety of marketing channels for enterprises, and 58.7 percent have provided firms with technological consulting and training. Township and village government-run enterprises were the major beneficiaries of this assistance. Song Lina and Du He<sup>8</sup> have

shown that some preferential treatment has been given to rural enterprises by township governments. For example, in some cases township governments have been able to secure for their enterprises some materials that were in short supply. Moreover, the initial capital of rural enterprise largely came from state loans. With the help of local governments, rural enterprises could obtain preferential treatments from banks, industrial and commercial administrative bureaus, and tax and supply departments. Furthermore, local government could help rural enterprise to raise some funds from society in general in order to overcome the shortage of funds in rural enterprises.

However, township and village governments exercised tight control over rural enterprises, especially township run enterprises and village run enterprises. For example, village and township governments took part in decisions for the selection of township enterprise managers.<sup>9</sup> Township and village government have been also directly involved in township enterprises management such as investment, planning, wage levels.<sup>10</sup> This enabled local government in some areas, in particular in backward areas, to extract excessive profits from rural enterprises, and it became clear that some rural enterprises, especially some township owned enterprises, had very low rates of efficiency. As a result, the Chinese government took measures to improve the situation. The main reform took place in traditional collective rural enterprises which were under the direct

administrative control of township or village authorities. The main reform aim was to separate government and enterprises and to reduce interference from township and village governments and thereby to increase the efficiency of the enterprises. Reforms however were based on no fundamental change in the status of collective ownership. The main reform measure was to implement the system of contractual responsibility.

Under this contractual responsibility system, all enterprises were contracted to managers, directors, workshops, production groups or to the entire staff. The contractor had management and utilization rights over the property of the enterprise. In other words, the contractor had decision-making rights over the manpower, finance and materials of the enterprise as well as over its production, marketing and sales. The contractor was still only the manager of the enterprise, not its owner; contracted responsibility did not entail a transfer of ownership.

All contracts specified an output quota in physical terms on the basis of the record of past production. The use of some material inputs was fixed in terms of the quantity that could be absorbed in production. Finally the gross income was specified and a profit target was fixed. The contractual obligations were reinforced by the bonus system by which success was rewarded. Part of the after-tax profits were used to pay bonuses to the workers and staff members, and failure was punished through financial penalties,



providing a strong incentive to fulfill contracts. This system of contracted responsibility for management has been widely implemented among township and town enterprises. Through different sorts of contracts, the management of township and town enterprises was entrusted to a collective or an individual.

Although management and business decisions have largely been left to enterprise directors as a result of the contract system, community governments were still intimately involved in important decisions such as investments, the establishment or dismantling of firms, significant changes in product lines, the appointment of enterprise management, managerial compensation, and bonuses. Community governments could also absorb risk for rural community enterprises and could also finance investments, both directly and through arranging other sources of funding such as bank loans. More generally, they still regard their collective enterprises as hostile administrative agents. Therefore, although traditional collective rural enterprises have gained more powers after implementing the contract system, township and village governments still deeply control township and village enterprises.

The assets of private rural enterprises belong to private entrepreneurs. Thus, township and village governments have less control over private rural enterprises than over collective rural enterprises, though as a result private rural enterprises can obtain less preferential

treatment than collective rural enterprises. However, it is still vital for private rural enterprises to have close relations with local officials since private enterprises still face a discriminating environment as I have discussed in Chapter Two.

Two surveys of private rural enterprises have revealed that there is a close relation between local officials and private entrepreneurs. In the first survey,<sup>11</sup> private entrepreneurs in the countryside were divided into the following types according to former occupation: (1) cadres, including the heads of Village Committees, secretaries of Village CCP Committees; (2) former supply and marketing staff in commune and brigade enterprises; (3) retired cadres or former workers or technicians and ordinary urban residents; (4) former specialized households; (5) ex-criminals <sup>12</sup>.

**Table 7.1. The Enterprises and the Size of the Enterprises**

Types of					
Entrepreneurs All Samples	(1)	(2)	(3)	(4)	(5)
Average Size					
of Enterprises	56.96	70.02	111.57	97.30	41.20 87.93

Unit: Annual output value, 10,000 yuan  
Source: Liu Xiaojing, 'Siying qiye jiankang fazhan de ruogan wenti -- 18 xing(shi) 130 ge siying qiye shizheng fenxi' (Some Issues in the Healthy Development of Private Enterprises: An Empirical Analysis of 130 Private Enterprises in 18 Provinces), *Nongye Jingji Wenti(Problems of Agricultural Economy)*, No.4, 1988(Monthly), p.41

Table 7.1 shows that the enterprises operated by entrepreneurs of the second, third and fifth category were the largest, or considerably large among private rural enterprises. Enterprises operated by the 'cadre' entrepreneurs type were not as large, but still ranked above the average size. The size of the enterprises operated by ordinary farmers operated was below average. This is due to the fact that most ordinary farmers lacked good 'guanxi',<sup>13</sup> specialized skills and experiences, and certain other advantages which other types of entrepreneurs enjoyed. The other survey<sup>14</sup> also showed that most entrepreneurs of private rural enterprises had special experiences. Before starting their enterprises, 10.3 percent had worked in state enterprises, undertakings or departments of government, 11.3 percent had been servicemen, 7.2 percent had been teachers, 18.6 percent had served as supply and marketing staff or as managers in township and village enterprises, and 17.5 percent had been village cadres. These findings show that there is a close relation between



local cadres and private entrepreneurs. As a result, private enterprises, like all other enterprises, are also subject to considerable township and village governments influence. For example, all private rural enterprises need permission from the community government in order to acquire land, buildings and bank loans. Close personal relationships with community government officials are thus necessary for private enterprises, if they are to flourish.

Therefore, township and village governments are equally important for both private and collective rural enterprises. William A. Byrd and Alan Gelb have indicated that "without the deep involvement of community governments, China's TVP sector could not have grown nearly as rapidly as it did in the late 1970s and early 1980s."<sup>15</sup> Alan Gelb and Jan Svejnar<sup>16</sup> argued that rural industrialization efforts have failed in Tanzania because local governments had no fiscal or other incentives to ensure their efficiency. As I have discussed in Chapter Six, after 1989 when China implemented a tightening policy towards rural enterprises, local government has played a very important role in protecting the development of rural enterprise. Township and village governments still have dual rights of ownership and management in the traditional collective rural enterprises. In the present situation, where the market is not fully operational in China's economy, state enterprises still dominate China's national economy. The protection of rural enterprises by local government is still essential in the

foreseeable future. However, the problem remains of how to prevent excessive levies on rural enterprises imposed by township and village governments. I will discuss this issue later.

## **7.2 Some Government Measures to Improve the Income Distribution of Rural Enterprise**

In this section, I will analyze the reform of wage systems within rural enterprises and the role of township and village government in determining wages in rural enterprises. Then I will examine what kinds of problems of profit distribution exist in rural enterprises and the impact upon profit distribution of government policy and provide some suggestions for future improvement.

### **7.2.1 The Reform of the Wage System in Rural Enterprises**

The older method of payment was a work points and bonus system. Workers' incomes related to the average income levels of the teams from which the workers came. When the work point system which linked agricultural and industrial incomes was used, all workers were paid an equal wage for equal work. Enterprises calculated in work points, which were then converted to a money wage according to the workpoint value of their team. However, since their income

did not relate to their individual performance, workers in rural enterprises did not have much incentive to work hard.

Since 1978, the payment system for labour in rural enterprises has been changed. Since the ownership systems of rural enterprises are different, and their profitability varies tremendously, and their means of production range from the advanced to the backward, different rural enterprises have adopted different wage systems in the light of their practical circumstances. The essence of wage system reform in rural enterprises was to find a system that would mobilize worker initiative in production, improve labour productivity, and facilitate production development. Wage systems in rural enterprises can basically be divided into the following five wage forms<sup>17</sup>:

The first wage system is the piece rate wage system. Under this system, a worker's wage is calculated in accordance with the number of products he makes which meet the required standards together with the unit rate for each product. The system may be subdivided into three forms -- the limited piece rate wage system, the mixed piece rate wage system and the graduated piece rate wage system: (a) under the unlimited piece rate wage system, a worker is paid for all his output, whether it falls within the quota or exceeds it, based on the unit rate for the product concerned; (b) under the mixed piece rate wage system, the worker is paid for fulfilling his quota in accordance with the amount of time he spends on it. For any output above the



quota, he is paid in accordance with the unit rate for output; and (c) under the graduated piece rate wage system, a worker is compensated for fulfilling his quota in accordance with a fixed unit rate for each unit of output. In addition, he is compensated for output above his quota in accordance with an ascending piece rate scale.

The second wage form is the time wage system. A worker is paid for the amount of time he works. The time wage system is subdivided into the hourly wage system, the daily wage system, and the monthly wage system. The time wage system is usually used in conjunction with an incentive system.

The third wage form is the contracting income (wage) system, used by the enterprises that adopt individual contracting. The contractor pays taxes in accordance with the contract, and defrays other expenses. The remainder is divided equitably among the workers in accordance with the amount of their labour, responsibilities, and contributions.

The fourth wage form is the profit-sharing system. A worker is paid a basic wage as compensation for fulfilling his quota. For his output beyond the quota, he is paid a fixed percentage of the enterprise's profit or earnings. In some enterprises, profits are distributed in accordance with the results of workers' labor, their attitudes toward work, and their level of technical expertise.

The fifth wage form is the floating wage system. Under this system, an enterprise adopts the existing standard wage

(plus bonus) as a basis and sets aside a certain percentage to be determined in accordance with the workers' work attitude, the magnitude of their contributions, and the balance sheets of the enterprise. A floating wage system can be applied in part or in whole.

These different wage forms have various advantages and disadvantages. The advantage of the piece rate wage system is that since it directly relates the output of a worker with his wage, it corrects an egalitarian bias in the calculation of wages, and improves labour efficiency. This wage system is more acceptable to workers because its quantitative and qualitative demands are more concrete and the system is relatively simple to administer. Its disadvantage is that in their eagerness to exceed their quotas and make more money, some workers pursue volume and ignore quality. Hence there is a need to strengthen quality control.

The advantage of the time wage system is that it guarantees a basic wage for workers. Under this system, all that is required is to determine a wage scale in accordance with the workers' technical standard and physical strength. However, the disadvantage is that under a time wage system, some people may do or contribute less than their capability.

Under the contracting income system, a worker's wage is calculated in accordance with net income. When the final accounts are settled at the year end, the greater the

enterprise's net earnings, the higher the workers' wages. Conversely, the smaller the enterprise's net earnings, the lower the workers' wages. Thus, labour, output, and compensation are integrated. Under this system, managers and workers all concern themselves with production, the trend of investment, and economic benefits.

The profit sharing system is more suitable for such industries as commerce, service, and repair. A worker is paid a basic wage each month after fulfilling his quota. This system encourages workers to give better services to customers.

The floating wage system is for strong enterprises. It works best in an enterprise where sound labour quota management and evaluation systems and a full production schedule exist and where production, supply, and marketing are relatively normal. Otherwise, it will be difficult to enforce.

Within any particular enterprise, it is common for one major wage system to be used in combination with and supplemented by others. Generally speaking, rural enterprises have shifted to the direct payment of workers, and performance based pay. This has provided an incentive for work and has improved efficiency in rural enterprises.

China's rural enterprises generally face a more complete market environment than do state enterprises. Therefore, local labour supply and demand have a stronger influence on their wages. Alan Gelb<sup>18</sup> found that TVP (township



enterprises, village enterprises and private enterprises) are directly linked to the enterprises' economic returns. However, township and village governments have varying degrees of control over rural enterprises, especially township-run and village-run enterprises. "Even if two communities have similar labour markets, their governments may exercise different forms of noneconomic control over TVP employees' incomes."<sup>19</sup> A study of Wuxi, Nanhai, and Jieshou<sup>20</sup> indicated that alternative opportunities play a great role in determining wage levels in different localities with similar levels of economic development. When township enterprises have absolute superiority, and competition from private enterprises is weak, the township government is likely to exercise stricter control over employment and wage of township enterprise workers. If there is fierce competition from private enterprises, township governments have relaxed their noneconomic control over wages in township enterprises. For example, in Wuxi, where most rural enterprises are township and village run enterprises, wages have been to a large extent under the control of community governments.<sup>21</sup> However, in Nanhai and Jieshou where private rural enterprises accounted for a large proportion of rural enterprises, community governments have not played an important role in income distribution, and wages of workers and managers in rural enterprises have a strong linkage with profits or output.<sup>22</sup>

Because there has been no unified national system governing income distribution in township and town enterprises, the level of wages in rural enterprises has varied considerably. On average, however, the average wage level in rural enterprises generally was higher than that in agriculture. Although persons engaged in agriculture have greater opportunities to supplement their income from private sideline occupations, even so it was clear that in general rural enterprises paid their workers more than could be earned by farmers.<sup>23</sup> Within rural enterprises, wages of sales staff, technicians and directors were higher than those of workers. The sample from Wuxi and Jieshou revealed these income disparities within rural enterprises. The ratios of average monthly wages, with workers as 1.00, were 1.74 for sales staff, 1.91 for technicians, and 2.07 for directors in Wuxi. In Jieshou the figures are 1.40 for sale staff, 1.96 for technicians and 1.47 for directors.<sup>24</sup>

The structure of incomes in China in rural enterprises mainly arises out of wages. However, during 1980s some forms of income that were not work-related, such as interest on capital, have produced differential benefits. These forms of income mainly existed in rural private enterprises, and have resulted in a widening of income differential within rural enterprises, especially in private rural enterprises.

No exact statistics are available for the differential of income within the rural private sector, but it is known that some entrepreneurs have become millionaires (*Renminbi*).

The income earned by employers and employees in private enterprises also appears to differ widely. Moreover an investigation by Beijing's local government in 1987 revealed that the average monthly salary of employers was 14 times that of employees. The former was 1,600 yuan while the latter was 112 yuan. In Heilongjiang the ratio of average employer's income to average employee's income is 32 to 1, in Shanghai 40 to 1, and in Xian 59 to 1.<sup>25</sup> In general, therefore, China's entrepreneurs in private rural enterprises sector earned much more than employees collective rural enterprises; some are now among the wealthiest in China.

In sum, since 1978, the wage systems in rural enterprises have been changed to give workers a much greater incentive to work. Since rural enterprises face a more complete market environment, the forces of local labor supply and demand have a much stronger influence on their wages. However, township and village governments still retain a varying degree of control over the income distribution of rural enterprises. The degree of control over wages from township and village governments depends on whether there is strong competition from private enterprises. In general rural enterprises paid their workers more than could be earned by farmers. Wages of sales staff, technicians and directors were higher than those of workers. Income differentials in private rural enterprises were much higher than in collective rural enterprises. Private



entrepreneurs earned much more than employees of private and collective rural enterprises.

### **7.2.2 The Reform of Profit Distribution in Rural Enterprises**

Many problems in profit distribution in rural enterprises exist, and some of these problems are very serious. The main problems are as follows: the extraction by local governments of a large percentage of profit, collecting excessive charges, apportioning numerous expenses, and allowing township and town enterprises to retain little profit. The phenomenon of the "three many and three fews" has appeared in jointly run peasant enterprises: much distribution to the individual, much profit sharing among shareholders, and high incomes for many shareholders; little profit retained by the enterprise, little profit sharing for workers, and little income for hired workers.<sup>26</sup> An investigation of 97 rural enterprises<sup>27</sup> showed that in the first half of 1986, the enterprises paid a total of 1.047 million yuan in various charges and apportionments, which accounted for 23 percent of their sales profits. Moreover, these enterprises paid a total of 0.325 million yuan in unlawful charges, accounting for 7.1 percent of their sales profit.<sup>28</sup>

The shortage of local government funds is the main reason for local government exacting a large percentage of

profit and collecting excessive charges. Since 1978, there has been an increase in local government's expenditures on rural education, health, family planning, subsidies for military recruitment and militia training, and subsidies for households with difficulties, old-age homes, and other social welfare activities. This high level of social expenditure has led to encroachments on a large portion of rural enterprises profits.

William A. Byrd and Alan Gelb<sup>29</sup> found that the problem of fiscal predation was more serious in backward areas than in well-endowed areas. The reasons are as follows. First, in better-off areas there was a strong base of existing community enterprises, and so most community governments were in a relatively comfortable financial situation. Secondly, these areas had more personal incomes and bank deposits which could be used for loans to rural enterprises. As a result, more funds were available for reinvestment to develop rural enterprises. By contrast, in backward areas the development of rural enterprises was much more limited. The difficult financial situation of community governments made them draw funds from community enterprises for public expenditures regardless of the enterprises' profitability and ability to pay. Even when firms were losing money, they still had to make payments to community governments in order to meet urgent and largely fixed public expenditure needs.

Due to the lack of unified standards for profit retention and distribution, practice differed widely from

place to place. For example, the Beijing Municipal Region has stipulated that township and town enterprises profits were distributed according to a "4:3:3" ratio. The enterprise retained 40 percent, handed in 30 percent to township government (or village government) to be used primarily for the support of agriculture, and delivered the remaining 30 percent to the township or village economic organizations (enterprise companies) to be used to expand production or build new enterprises.<sup>30</sup> In Simen Town, Yutao City, Zhejiang Province, a regulation was adopted using a "double 3-7" ratio in the distribution of after-tax township and town profit, in which 70 percent of after-tax profits was retained by the enterprises for use in expanded reproduction and 30 percent was given over to the town industrial bureau. Of the profit handed in, 70 percent was retained by the bureau to use in supporting the renovation of older enterprises and the building of new township and town enterprises, while 30 percent was given to the town government to use in the construction of small market towns and other expenditures of a social nature.<sup>31</sup>

Pertaining to the problem of township enterprises' heavy social burden, low profit retentions, and other problems, the State Economic Commission's agriculture, animal husbandry, and fishery departments have jointly issued a circular entitled "Several Suggestions on the Question of Township Enterprises' Profit Distributions."<sup>32</sup> Enterprises should be allowed to retain a minimum of 60



percent of the net profits. Village and township leaders should respect the right of the enterprises to operate their businesses and utilize their funds autonomously. Enterprises should have the right to reject equalitarianism and indiscriminate transfer of resources or unreasonable apportionment. However, the community's or the region's economic interests could undermine the authority of the central government and effectiveness of its functioning departments. Since most township and villages governments have the shortage of funds, the pressure on them to extract excessive funds from rural enterprises is immense.

Some scholars have provided some good suggestions to prevent fiscal predation by township and village governments. William A. Byrd and Alan Gelb<sup>33</sup> have suggested that the size of community government and the number of cadres should be reduced to correspond better with local community resources, and that some expenditures on activities such as primary education which are important to national objectives should be included in the state budget. These are indeed good suggestions. However, China's agricultural investment from central government is still limited, and this means that local governments require rural enterprises to turn over a large portion of funds from their profits for the development of agriculture.<sup>34</sup> In addition, China's state budget itself requires the turning over of a large portion of funds from the profits of rural enterprises. Therefore, although China's central government

has formulated some measures to reduce financial burden of rural enterprises, some problems of profit distribution still remain in rural enterprises, and will exist in the foreseeable future.

### **7.3 Government Policy towards Product Quality of Rural Enterprises**

The improvement of product quality is another important issue of management. In this section, I will discuss what kinds of problems of product quality in rural enterprises existed since 1978, and how government policy sought to deal with them.

In general, technological level in rural enterprises is inferior. This is one of main reasons for its low level of product quality. According to an investigation in some township and town enterprises in Jiangsu and Shandong in 1986<sup>35</sup>, in many enterprises awareness of quality was quite poor. Emphasis was given to output and profits, not to quality. There were either no standards in product manufacturing or work was not done according to standards. Product quality was not stable. For example, of 16 products in Wuxi selected by the Bureau of Standards Jiangsu, only 7, or 44 percent, were up to standard.<sup>36</sup> According to this analysis, the proportion of products up to standard throughout the province was estimated at approximately 50 percent. In Yantai, Shandong 1,402 products from 990

enterprises were examined and 67.2 percent were found to be up to standard. Problems in product quality in some firms, particularly food enterprises, were even more serious. Of 162 products in 140 enterprises throughout the province, only 45 percent were up to standard.<sup>37</sup>

Considerable numbers of enterprises lack even the most basic quality guarantees, and did not have the capacity to manufacture products that were up to standard. For example, in Jiangsu, over 50 percent of industrial products in township and town enterprises were substandard. Most enterprises were "imperfect in four areas", that is, in blueprints, standards, technology, and structure, so it was very difficult to guarantee quality. In Shandong 2,078 enterprises were investigated. Of these, 361, or 17.4 percent, lacked blueprints and technology; 252, or 12.1 percent, lacked an inspection system; and 503, or 24.7 percent, had unsound examination and measuring methods.<sup>38</sup>

A few enterprises used inferior material and did shoddy work, manufactured goods in a rough and slipshod way and even palmed off inferior goods as brand name products. For example, in Yantai, in 1985, 870 bicycles, 725 cartons of cigarettes, and 46,000 bottles of alcohol and beverages, were found, all with fake name brands came from other parts of the country.<sup>39</sup> Circumstances such as these have been discovered in quality inspections throughout the country.

In addition, below the village level (including cooperative enterprise, joint households and individual



enterprises) there was basically no one in charge of product quality.<sup>40</sup>

Thus, the problem of product quality in rural enterprises was quite serious. In response to the problems, the State Economic Commission, Ministry of Agriculture, Animal Husbandry, and Fishery and the State Industry and Commerce Administration formulated "Opinions on Strengthening Product Quality Management Work in Township and Town."

"All township and town enterprises must do more to correct their administrative ideology, adhere earnestly to the principle of 'quality is number one' and strive to improve management and administration, raise economic results, and be concerned with preventing pollution of the environment." <sup>41</sup>

"The opinions" called for township and town enterprises administrative departments to establish quality management organs to work in conjunction with industrial management departments and industrial and commercial administration organs and thereby to strength management and supervision over product quality.

"The opinion" suggested focusing on industrial enterprises at the township (town) level and key village-run industrial enterprises. The main concern for industrial enterprises below the village level was to strengthen quality supervision.

"The opinion" also called for township and town enterprises to organize production according to technical standards and technical norms and on the basis of the principle of "five things not permitted"<sup>42</sup> and "three things are not permitted".<sup>43</sup>

This account show that China's central government has been aware of the importance of product quality, and has taken some steps to improve product quality in rural enterprises. Information published in 1990<sup>44</sup> has disclosed that the quality of China's rural enterprises has improved. The proportion of superior-quality products produced by rural enterprises has risen. Some products have even earned a good reputation in the international market. The amount of high quality products produced and the amount of high-level equipment owned by rural enterprises is increasing steadily, in particular in the fields of electronics, light industry, textiles, and building materials.<sup>45</sup> Thus, it seems that government policy has had some effects in promoting product quality in rural enterprises.

In summary, although the quality of goods produced in rural enterprises is still low. China's central government has implemented a policy of improving product quality in rural enterprises, and this policy has played a positive role in promoting the product quality of rural enterprises.

#### 7.4 Conclusion

Since 1978, fiscal revenues of township and village governments largely depended on the incomes from rural enterprises. In addition, there was a very close interest relation between township and village government leaders and the development of rural enterprises. Furthermore, the development of rural enterprises has played a very important role in increasing the incomes of rural community members and solving the problem of rural surplus labour. Thus, township and village governments actively defended the interests of rural enterprises and promoted the development of rural enterprises. In China, rural enterprises are lower in status than state-run enterprises, and as a result, they obtain less preferential treatments from central government. Under this situation, it is essential for rural enterprises to obtain some protection for township and village governments, though it is true that "for quite a long time it will be necessary for township governments to directly control some enterprises and to realize community goals through concerted efforts with enterprises."<sup>46</sup>

Since 1978 different wage forms have been used in rural enterprises. The reform of the wage systems in rural enterprises has given workers a greater incentive to work. This has promoted the efficiency of rural enterprises. Since rural enterprises have faced a more complete market



environment, local forces of labour supply and demand have had a stronger influence on their wages. Unlike China's state enterprises, rural enterprises were directly linked to the enterprises' economic returns. However, township and village governments have varying degrees of control over rural enterprises. Rural enterprises paid their workers more than could be earned by farmers. Wages of sales staff, technicians and directors, especially private entrepreneurs were higher than workers. These income differentials will be widened since private rural enterprises develop at a faster rate and private rural enterprises have less control over wage differential from township and village governments.

The shortage of fiscal income and local government funds for welfare work and agricultural funds has led to the problem of local government exacting a large percentage of profit, collecting excessive charges. Although China's central government has implemented a policy of reducing the financial burden of rural enterprises, some problems of profit distribution have still remained. In order to reduce the financial burden on rural enterprises, further measures such as the increase of agricultural investment and state budget for primary education from central government and the reduction of the number of leaders in township and village governments will be useful.

Product quality in rural enterprises is still low. China's central government has implemented a policy to improve product quality in rural enterprises since 1978.

This policy has played a positive role in promoting product quality in rural enterprises. It may be necessary to establish special offices to employ professional personnel to implement strict control of product quality and to give positive support for the improvement of product quality in rural enterprises. The current technological level in rural enterprises is however still inferior. In order to further improve product quality of rural enterprises, it is necessary to promote the level of technology in rural enterprises. Since 1978, China's government has adopted some measures to promote technology in rural enterprises. In the next chapter, I will examine how these policies have influenced technological progress in rural enterprises.

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4. *ibid.*
5. *ibid.*
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7. Du Haiyan, "Analysis of China's Town and Township Enterprise Administrative System," *Zhongguo Nongcun Jingji* (China Rural Economy), No. 6, 21 Jun 88, pp.21-32.
8. Song Lina and Du He, *op.cit.*, pp. 342-357.
9. *ibid.*
10. *ibid.*
11. Liu Xiaojing, "Siying qiye jiankang fazhan de ruogan wenti -- 18 xing(shi) 130 ge siying qiye shizheng fenxi' (Some Issues in the Healthy Development of Private Enterprises: An Empirical Analysis of 130 Private Enterprises in 18 Provinces)," *Nongye Jingji Wenti* (Problems of Agricultural Economy), No.4, 1988(Monthly), pp.38-42
12. Ex-criminals are a special category of the entrepreneurs who have been in jail. Some of them are innocent people or victims of Chinese political struggles. Liu Xiaojing, *op.cit.*, p. 40.
13. 'guanxi' signifies functional and social linkages in economics and politics.
14. "Dui baijia nongcun siying qiye diaocha de chubu fenxi (An Initial Analysis of the Survey of 100 Private rural enterprises)," *Nongye Jingji Wenti* (Problems of Agricultural Economy), No.2, 1989 (Monthly), pp.18-23.
15. William A.Byrd and Alan Gelb, *op.cit.*
16. Alan Gelb and Jan Svejnar, "Chinese TVPs in an International Perspective," in edited by William A.Byrd and Lin Qingsong, *China's Rural Industry--Structure, Development, and Reform*, Oxford University Press, pp. 342-357.
17. Bao Weihuo, "Variety of Wage System for Diverse Small-scale Enterprises," *Nongcun Caiwu Kuaiji* (Rural Financial Accounting), No. 7, 6 July, 1986, pp 26-28.
18. Alan Gelb, "TVP Workers' Incomes, Incentives, and Attitudes," in edited by William A.Byrd and Lin Qingsong, *China's Rural Industry--Structure, Development, and Reform*, Oxford University Press, pp.280-298.
19. Wu Quhui, Wang Hansheng, and Xu Xinxin, "Noneconomic Determinants of Workers' Incomes," in edited by William A.Byrd and Lin Qingsong, *China's Rural Industry--Structure,*



*Development, and Reform*, Oxford University Press, pp.323-337.

20. *ibid.*

21. *ibid.*

22. *ibid.*

23. There is a case which agricultural income caught up with and even surpassed those of rural enterprises workers partly because of strict administrative controls over wages. see, Meng Xin, "The Rural Labor Market," in edited by William A.Byrd and Lin Qingsong, *China's Rural Industry--Structure, Development, and Reform*, Oxford University Press, pp.299-322.

24. Wu Quhui, Wang Hansheng, and Xu Xinxin, *op.cit*, p.330.

25. "The Development of Private Enterprises in Our Country and Initial Policy Measures," *Caijin Yangjiu(Finance & Economics Research)*, Shanghai, No.10, 1987, pp.48-53, translated in *Inside China Mainland*, Vol.10, No.2, February 1988, pp.5-6.

26. Bao Weihe, "Suggestions on Profit Distribution Reform of Township and Enterprises," *Nongye Kuaiji Yanjiu (Agricultural Accounting Research)*, No.2, 86, pp.20-22.

27. The investigation were from 97 collective enterprises(73 town and township enterprises and 24 village-run enterprises) in the 10 townships(towns) and 10 villages under the jurisdiction of Handan City. See, "Serious Problems of Small Retained Profits and Inadequate Reserve Strength in Enterprises--Investigation on Profit Distribution in Town and Township Enterprises," *Nongmin Ribao(Peasant Daily)*, 13 Nov 86, p.2.

28. *ibid.*

29. William A.Byrd and Alan Gelb, *op.cit.*

30. Bao Weihe, *op.cit.*

31. *ibid.*

32. *Nongmin Ribao(Peasant Daily)*, 22 Dec 86, p.1.

33. William A.Byrd and Alan Gelb, *op.cit.*

34. Zhang Xiaoli and Liu Yaguang, "Industrial Subsidy of Agriculture is the Strategic Measure to Stabilize Agriculture," *Sichuan Ribao*, 15 Sep 86, p.2.

35. "Shift Focus of Work to Product Quality; Report on Product-Quality Inspection in Jiangsu and Shandong Township and Town Enterprises," *Zhongguo Xiangzhen Qiye Bao(Chinese Township and Town Enterprises)*, 15 Jan 86 p.3, JARS-CEA-86-040, 11 April.

36. *ibid.*

37. *ibid.*

38. *ibid.*

39. *ibid.*

40. *ibid.*

41. "Opinions on Strengthening Product Quality Management Work in Township and Town Industries," *Zhongguo Xiangzhen Qiye Bao(Chinese Township and Town Daily)*, 12 Mar 86, P.3

42. "five things not permitted" : (1) substandard products should not leave the factory nor be included in output or value of output; (2) substandard raw materials and parts

cannot be used or assembled; (3) products whose demise has been announced cannot be sold; (4) nothing can be produced if there are no product quality standards, quality-inspection organs or quality-inspection measures; (5) there can be no deception, switching substandard products for good ones, fake labeling or fraudulent brands.

43. "three thing are not permitted": the first is not permitting substandard products to leave the factory, the second is not permitting the production and sale of products that have been eliminated, and the third is not permitting fraud.

44. Wang Jian, "Assessment of the Development of China's Township Enterprises in 1990," *Liaowang(outlook)*, Overseas Edition, No. 49, 3 Dec 90, pp.3-4.

45. *ibid.*

46. Song lina and Du He, *op.cit.*

## **Chapter 8 Government Policies to Promote Technology in Rural Enterprises**

In the former chapter, I have discussed government policies to promote management in rural enterprises. In this chapter, I will examine government policies to promote technological progress in rural enterprises since 1978. There is much published discussion on the economic aspects of technological change. However, there is considerable difference of opinion on several issues such as the causes and effects of technological change. For example, On the plus side, as a result of technological changes more and better durable consumer goods become available to most people, however, on the debit side, pessimists argue that while pessimists point out that automation can lead to unemployment and more or less enforced leisure on a large scale. However, the author has not found that any economist has denied the importance of technological change as a very important source of economic growth. Paul A. David's research on the American and British experience in the nineteenth century has indicated that a single, distinct technological innovation may lead to aggregate economic growth.<sup>1</sup> Kazushi Ohkawa and Henry Rosovsky found that institutional changes as well as experience with new technologies stimulated Japan's social capability to import and eventually improve on advanced foreign production



methods.<sup>2</sup> Despite political disruptions, China has also illustrated the important role of science and technology development on economic and social development. Tony Saich's research has demonstrated that "there is a clear recognition of the important role that science and technology plays in achieving economic and social objectives", and "the process of reform has led to the realization that much greater attention must be paid to the process of science and technology development itself."<sup>3</sup>

The concern in this paper is to examine one aspect of the impact of science and technology development on Chinese economic development--the impact on rural enterprises. In so doing, first I will analyze the level of technology in rural enterprises. Then I will analyze government technological strategy before and after 1978. Next I will examine the progress of technology in rural enterprises. Finally I will analyze the prospects for technological progress in rural enterprises.

### **8.1 The Level of Technology in Rural Enterprises**

Technological level is defined as a general index of the scientific inputs and outputs of the enterprises. This index is examined in terms of material input of science and technology, the sophistication of machinery, number and quality of technological personnel, and stock of labour and capital of the enterprises.

In China's rural enterprises, old and new equipment exists side by side in most rural enterprises. The technological modernization process is more advanced in the coastal regions, but even in the coastal regions many rural enterprises still use old technology and equipment. Less than 20 percent of the equipment was made in the 1970s and 1980s; over 60 percent was made in the 1950s and 1960s; and about 20 percent is basically primitive hand-operated equipment.<sup>4</sup> The quality of workers and staff tends to be low. The capacity of these enterprises to develop new products on their own is also extremely limited. This means that they have to depend on technological assistance from outside to make the fullest use of technology. Lack of local technological capacity arises from the absence of any in-house research and design facilities. Assistance is sought by these enterprises from either large enterprises or from research institutes or universities. The proportion of technically trained personnel is only one-tenth that in state-run enterprises. The quality of 70-90 percent of all products is lower than the products of state-run enterprises. There tend to be more products of medium and inferior quality, more old-style products, and fewer new products.<sup>5</sup>

One survey<sup>6</sup> showed that in the sample enterprises, the equipment came from the following sources: 37% was new equipment which was ordered from the factories; 29% was bought from the market; 13% was old equipment bought from

factories; 10% was the equipment which had been retired from state-run factories; 9% was made by themselves; 2% was imported from overseas.

**Table 8.1 The Level of Technology in Sample Rural Enterprises**

Level of Techniques	No. of Enterprises	Percentage
Before 1949 equipment	45	1
50's equipment	1,363	31
70's equipment	2,505	58
80's equipment	438	10

Source:

Bi Guohua and Bao Yonghong, "An Analytical Report of the Questionnaire Data on Macro-Management of Township and Town Enterprises", *Agricultural Economy*, Liaoning, China, No.3, 1989, p.4.

The data in table 8.1 indicate that only 10% of these sample enterprises's equipment was made in 1980s. Most equipment in sample enterprises was out-of-date.

Large and medium sized industrial enterprises have much higher technology than rural industrial enterprises. Appendix 2 and Appendix 3 indicate that technological personnel per 1000 workers and original value of fixed assets per worker engaged at the end of 1985 were much higher than those in rural industrial enterprises. As a result, large and medium sized industrial enterprises are more efficient than rural industrial enterprises as indicated by net value of output per worker in 1985 Appendix 4. However, the level of technology in the different branches of Chinese rural industry is quite varied. The level of technology in light industry is more advanced than that in heavy industry. This can also be seen from Appendix



5, Appendix 6 and Appendix 7. However, during the 80s, the investment of fixed assets has increased significantly. The total investment of fixed assets in sample rural industrial enterprises from 1981 to 1985 accounted for 65.61 percent of total investment of fixed assets in sample rural industrial enterprises since 1949. In addition, the fairly high percentage of equipment value relating to years just preceding the 1985 survey date might also suggest considerable modernization of equipment in rural industrial enterprises. However, the much higher cost of recent acquisition would tend to exaggerate the extent to which production is carried on with modern equipment.

Despite the considerable investment in new equipment since 1978, the low level of technology in rural enterprises is probably the main reason for the low quality of products. According to the investigation in 1986 in 110,000 intermediate level rural enterprises, within 13,000 products 221 products reached international advanced level, or only 1.65%. There were 916 backward products, accounting for 6.8%. Most of products were ordinary products, accounting for 91.5%.<sup>7</sup>

According to research conducted in some township and town enterprises in Jiangsu and Shandong<sup>8</sup>, fair numbers of enterprises lack even the most basic quality guarantees, and do not have the capacity to manufacture products that are up to standard. For example, in Jiangsu, in 1986 over 50 percent of industrial products in township and town

enterprises are substandard. Most enterprises were "imperfect in four areas", that is, in blueprints, standards, technology, and structure, so it is very difficult to guarantee quality. In Shandong 2,078 enterprises were investigated. Of these, 361, or 17.4 percent, lacked blueprints and technology; 252, or 12.1 percent, lacked an inspection system; and 503, or 24.7 percent, had unsound examination and measuring methods.<sup>9</sup> Thus, the problem of product quality in township and town enterprises is quite striking.

In summary, in general, the level of technology in most rural enterprises is inferior. The low level of technology is one of the main reasons of the low quality of products.

## **8.2 Government Technological Strategy for Rural Enterprises**

During 1955-57 China launched a large-scale agricultural cooperative movement. Commune and brigade enterprises, the predecessors of rural enterprises, began to emerge and develop on the basis of collective sideline production.

During the Great Leap Forward, the choice of techniques strategy was an essential part of the "walking on two legs"<sup>10</sup> approach, which entailed primary but temporary emphasis upon small-scale, labour-intensive methods of production within the framework of long-term priority for

large-scale and capital-intensive techniques.<sup>11</sup> The Great Leap Forward policy attempted rapid rural industrialization through mass mobilization and the use of primitive techniques. Because premature expansion of small plants led to waste and confusion, many commune and brigade enterprises were closed during the retrenchment of 1960-1962. But as agricultural conditions stabilized and the opportunity cost of small-scale industrial ventures declined, official policy began once again to encourage local industrial development. The volume of the resources devoted to commune and brigade enterprises has expanded steadily since 1963. Careful attention to pilot projects, cost reduction, and quality control has led to improved results.<sup>12</sup>

As research by Samuel P.S.Ho<sup>13</sup> has indicated, rural industry differs from urban industry because it exists primarily to serve agriculture and local markets, consists mostly of small plants using primitive or intermediate technology, and depends on local resources. However, after 1978 although China still demanded that rural enterprises support agriculture, rural enterprises have been considered as a policy of strategic significance in solving rural surplus labour and as an important source of the peasants' increased income.<sup>14</sup> Technological strategy places emphasis upon appropriate technologies. Although most rural enterprises are still small-scale and engage in labour-intensive methods of production, the State has not restricted rural enterprises wishing to become large-scale



and capital-intensive. An important official report clearly indicated this strategy.

"Commune and brigade enterprises should not arbitrarily seek advanced equipment and technology without considering their actual conditions, nor should they be contended with their backwardness in technology and refuse to advance. They should adopt "suitable technologies" on the basis of their respective salient features."<sup>15</sup>

The report suggested that the State should adopt a policy favourable to the replacement of very old equipment. The rate of depreciation on old fixed assets might be raised appropriately. With regard to the use of after-tax profits, the report suggested that priority should generally be given to technological transformation.

In addition, the report encouraged cooperation in technology between state enterprises and rural enterprises, and between scientific research departments, colleges or institutions of higher training and rural enterprises. At the same time, the report offered some suggestions to improve the lack of technological personnel in rural enterprises. This will be analyzed below.

Faced with the reality of a backward and generally inefficient domestic science and technology system, Chinese leaders have been engaged in an effort to re-structure their research sector and modernize indigenous science and technology capabilities since 1978.<sup>16</sup> The March 1978

National Science Conference in Beijing was a milestone in the reform of science policy. Its main purpose was to announce publicly the government and party policy of encouragement and support of science and technology. A major speech by Deng Xiaoping reiterated the concept of science as a productive force and scientists as workers. However, the fundamental reform of the science and technology management system was made by the March 1985 Central Committee Decision. The reforms proposed in the "Decision on the Reform of the Science and Technology Management System"<sup>17</sup> represented a major break with past practices, by changing the method of funding research institutes, encouraging the commercialization of technology and the development of a technology market and rewarding individual scientists. It was envisaged that most research institutes would support themselves through partnerships, mergers, joint ventures, or other appropriate and mutually agreeable means. The ultimate goal was to encourage exchange and cooperation and to break down the compartmentalization characterizing China's research and development structure.

The reform of the science and technology management system has very important implications for the technological development of rural enterprises. As I will discuss later, increasing numbers of technological personnel have worked in rural enterprises. Technological cooperation between state enterprises and rural enterprises and between research institutes and universities and rural enterprises have taken

place. A technology market and the commercialization of technology in the late 1980s were developed to encourage the transfer of technology and the transformation of research results into products and services. Thus, rural enterprises have opportunities to get technology through the technological market and via the system for the transfer of technology.

Various technological fairs have operated since 1978. For example, Jilin Province signed a number of contracts and agreements on technological cooperation and transfers in the first North-east China technological cooperation fair on 26 April 1986. The total transaction volume reached 40m yuan.<sup>18</sup> According to statistics released by 17 departments in 22 provinces, autonomous regions and municipalities, about 87,000 contracts, worth 2.06 bn yuan were signed at the market in 1986. China has 5,000 organizations handling technological business activities, while 10,000 state-run and 10,000 privately-run research institutes are becoming more active in the country's commodity and technological markets.<sup>19</sup>

Private scientific research institutes have been allowed to be established since 1978. According to statistics, China had 10,000 private scientific research institutes with 800,000 employees in 1987, which made profits by selling the application of their discoveries. 308 private scientific research institutes located in 20 cities



have technologically aided 221 small and village and township enterprises during 1985 to 1986.<sup>20</sup>

Some private scientific research institutes have set up experimental plants in rural areas. One experimental factory was jointly launched by a private institute and a village in Dalian. With the help of the private institute, the factory, which went into operation in 1985 with an investment of 1.5 million yuan, sold its products to a dozen major cities. The institute was based in a rural area and had helped 30 rural enterprises become profitable.<sup>21</sup>

China's leadership also expected rural enterprises to play an important role in the development of the export-oriented economy.<sup>22</sup> Some rural enterprises in coastal areas have engaged in the processing of imported material, assembly of imported parts and compensation trade. In 1985, more than 8,000 township enterprises nationwide earned foreign exchange through exports. They produced 20 major categories, more than 10,000 varieties of products sold in nearly a hundred nations worldwide, and earned more than \$4 billion, 15.5 percent of the nation's total foreign exchange earnings in 1985.<sup>23</sup> Some rural enterprises in coastal areas have also cooperated with foreign businesses. This will be discussed later. As a result, such enterprises have an opportunity to use foreign advanced technology.

Because the development of rural enterprises in China is uneven<sup>24</sup>, different regions have been given different strategies for technological improvement. In the

interior and in other regions where rural enterprises are relatively underdeveloped, technological improvement has emphasized the promotion of traditional arts and crafts. But in the coastal areas where rural enterprises are relatively advanced, input of more advanced technology has taken place. This could further widen the regional imbalance in the development of rural enterprises.

Since 1989, the Chinese leadership has emphasized the development of state enterprises. Despite this, Chinese official documents still support technological progress in rural enterprises. One document calls for the government to organize and guide technological progress, staff training, and to create the conditions for rural enterprises to recruit skilled personnel and import advanced technology.<sup>25</sup>

However, it should be noted that the support and favourable conditions for technological progress in official documents were given more to township and village collective run enterprises than to private rural enterprises. This is due to the discrimination against private enterprises and to the low stature of private enterprises.<sup>26</sup>

China has tried to improve the quality of rural enterprises' products. In 1986, the State Economic Commission, Ministry of Agriculture, Animal Husbandry, and Fishery and the State Industry and Commerce Administration studied and formulated these "Opinions on Strengthening Product Quality Management Work in Township and Town."

"All township and town enterprises must do more to correct their administrative ideology, adhere earnestly to the principle of 'quality is number one' and strive to improve management and administration, raise economic results, and be concerned with preventing pollution of the environment."<sup>27</sup>

"The opinions" called for township and town enterprises administrative departments to establish quality management organs to work in conjunction with industrial management departments and industry and commerce administration organs to strength management and supervision over product quality.

"The opinion" also called for township and town enterprises to organize production according to product technical standards and technical norms and on the basis of the principle of "five things not permitted"<sup>28</sup> and "three things are not permitted"<sup>29</sup> in township and town enterprises.

Since 1978, the most important promotion of the application of modern science and technology to rural enterprises was the State introduced "Spark Plan". In essence, the programme was intended to replace the outdated equipment in rural areas by modern factory methods. This will be discussed below.

To sum up this section, during the 1980s technological strategy for rural enterprises has been changed from the



emphasis on small-scale, labour-intensive methods of production and primitive or intermediate technology to the use of appropriate technology. The reform of the science and technology management system has given rural enterprises opportunity to obtain advanced technology. The open door policy and the policy of encouraging higher quality of products in rural enterprises has important implications for the promotion of technological progress in rural enterprises. The Chinese Government has also given some practical support towards technological progress of rural enterprises.

### **8.3 The Progress of Technology in Rural Enterprises**

In this section, I will examine the progress of technology in Rural enterprises. This includes the following aspects: the "Spark Plan" towards rural enterprises; technological personnel in rural enterprises; cooperation in technology between state enterprises and rural enterprises and between research institutes and universities and rural enterprises.

#### **8.3.1 The Spark Plan (Xinghuo Jihua)**

The "Spark Plan" was initiated by the State Science and Technology Commission in March 1985. The plan, which derives its name from a Chinese metaphor that says a single

spark can start a prairie fire, aims at introducing modern science and techniques to the rural districts through the medium of technological demonstration centres with the object of accelerating economic growth in the countryside.<sup>30</sup> The "Spark Plan" was proposed in the spirit of the resolution by the Central Committee to restructure the science and technology system, and is aimed at invigorating the local economy.<sup>31</sup> The targets of the plan during the Seventh five-year Plan are: (1) to develop 100 complete sets of technological equipment suitable for the countryside and the town and township enterprises, and put them into batch production; (2) to help establish 500 model town and township enterprises and provide them with complete technology and production techniques and methods of standard management, product design and quality control; (3) to train a number of educated youths and grassroots cadres for towns and townships every year so that they can master one or two advanced technologies suitable for their own areas and obtain some knowledge of modern management.<sup>32</sup> In principle, the "short, level, and speedy"<sup>33</sup> projects undertaken by the "spark plan" differ from key scientific and technical projects that are medium and long term, and they are also different from those that are "small, indigenous, and mass-run"<sup>34</sup>.

The Spark Plan will introduce technology of a higher level in China's eastern seaboard to help produce better quality goods for the export market. Assistance will be

given to help the central part of China manufacture goods for the domestic market, so as to lay the foundation for starting an export-oriented economy. Under-developed western China is where the plan can help most by introducing techniques to enable millions of rural households to become well-to-do. The plan will help enterprises in western China to enter into cooperation with those in the central and eastern parts of the country so that they can turn out market goods with local characteristics.

A whole series of new measures were adopted: all projects to be listed as "Spark Plans" must undergo feasibility studies by experts and are no longer started up after nothing more than a simple administrative investigation. Technical projects for rural enterprises to be listed must have a technical institute, scientific research unit, or large or mid-sized enterprises to look to, in order to assure that the project is both advanced and appropriate. Some projects are not arranged through administrative channels but through public announcements in newspapers which solicit technological personnel and have the support of the state for loans. Capital accumulation channels have been expanded. Bonds and stocks were issued, and enterprises linked up to accumulate capital. All forms of venture capital investment and leasing system have been tried.<sup>35</sup>

Many kinds of technology transfer systems have been established. Compensation has been paid for the transfer of



technological contracts and markets for information and technology have been created. For example, a total of 87 out of 98 counties and prefecture have started rural technology markets, resulting in the spread of appropriate technology through a large segment of rural enterprises.<sup>36</sup> Human resource exchange agencies have also been established. Science and technology workers have been given incentives to go to work in rural enterprises.

These new methods have provided favourable conditions for the implementation of the "Spark Plans". Between 1985 and 1987, the state put up 360 million yuan in support of the "Spark Plans". The capital accumulation in the different regions reached 1.9 billion yuan.<sup>37</sup> These funds have been used to develop technological application in 10 areas: new modes in the feed industries and for storing and shipping their products; processing technology for preserving freshness at the point of production; technology for the comprehensive use of farm, forestry and local products; development of rural township construction materials; production technology for small-scale mining excavation, extraction, primary processing and manufacturing; broadened utilization of new technology and materials; product lines for heavy industrial production; coordinated regional development; export commodities; and development of small-scale production installation technology and training of installation personnel.<sup>38</sup>

The work of personnel training has gone forward as well. Training centers have been set up all around the country; and 1.05 million young peasants with intermediate education levels have participated.<sup>39</sup>

After three years' implementation, the Spark Plan has achieved visible success. By the end of 1988, 5,100 projects were completed, increasing output value by 11.2 billion yuan and profits and taxes delivered to the state by 3.6 billion yuan, earning 1.6 billion yuan in foreign exchange, and enabling the input-output ratio to reach 1:5 <sup>40</sup>

Thus, the implementation of the Spark Plan has gained some successes for the improvement of technology in some rural enterprises. However, this program has been far from adequate compared with the number and size of rural enterprises in all China. As noted above, most rural enterprises still lack sufficient technological personnel, and use out-dated facilities, often procured from state and collective enterprises that have upgraded their technological base. Although the reliance on second hand equipment is a cheap way of obtaining productive capacity in the short run, much of it is highly inefficient, and highly energy consumptive. Thus, although the Spark Plan marks an important step in the right direction, much work still remains to be done if the technology level in rural enterprises is to be improved.

### 8.3.2 Technological Personnel

Since 1978, some enterprises faced bankruptcy and some went out of business. The most important reason for their failure was the lack of competent managers and technicians. For instance, Nanggong County in Hebei, Chuiyang township spent 110,000 yuan on a set of advanced shoe-making equipment. Yet none of the seven "technicians" it successively hired from outside at a high salary had mastered the entire spectrum of shoe technology and they were particularly inadequate when it came to design. The enterprise failed 4 months after it went into business.<sup>41</sup> Professional technicians make up a small proportion of the workers in rural enterprises. In 1986, 1,520,000 rural enterprises surveyed had only 630,000 professional technicians, an average of 0.4 technicians for one enterprise. For all the 43.91 million rural workers, technicians accounted for only 0.7 percent of the total. The percentage for State enterprises was 8.8 per cent.<sup>42</sup>

In order to improve the situation of lack of technological personnel in rural enterprises, a Chinese official document suggested that the following steps should be taken: First, the education department should include rural enterprises' requirements for personnel in the plan for developing vocational education and gradually establish professional schools for training staff members and staff.



Secondly, the state should assign some university and college graduates to rural enterprises. Thirdly, rural enterprises should be allowed to give proper titles to their technological personnel by referring to the criteria promulgated by the state in order to encourage the staff members and workers to become competent personnel through self-study. <sup>43</sup>

Meanwhile, the Chinese government has also accelerated, especially since 1985, the introduction and training of technological and management personnel for township and town enterprises. According to an investigation in 1985 involving 23 provinces and municipalities, a total of 65,000 capable people were recruited by township and town enterprises and 600,000 technological and management personnel were trained. A special characteristic of the work to cultivate talented personnel has been the operation of educational and training programs for staff and workers at various levels, through various channels, and in various forms. <sup>44</sup>

The State also adopted a more liberal policy which has allowed technological personnel to work in rural enterprises in their spare time. In certain big cities such as Shanghai and Beijing, groups of scientific technological personnel travelled to suburbs from downtown either by bus or bicycle on Sunday to use their spare time to help rural enterprises develop new products, tackle technological problems, and train workers. This was very useful in solving the problems of technology in rural enterprise.

However, very few technological personnel in state enterprises can settle in rural areas and work in rural enterprises. The main reasons are as follows: first, some leaders of the State departments fear that once the scientific and technological personnel go to work in rural enterprise, they will become their rivals, and that the scientific and technological personnel going to work in rural enterprises and getting higher wages will affect the stability and ideology of the scientific and technological personnel who still work in their departments.

Second, the personnel are afraid of losing their "iron rice bowls". In China, state employees receive a broad array of subsidies for basic consumption goods, services, and other benefits that are not provided to farmers. In 1978 these included subsidies for grain, vegetable oils, and subsidiary foods, for housing, retirement, death, maternity, disability, injury, and some types of health benefits and labour insurance fees, etc. These subsidies in 1978 totaled 528 yuan per year per employee or 82 percent of the average wage.<sup>45</sup> If they go to rural enterprises to work, they will lose these subsidies.

Third, there is an ideological and political reason why very few technological personnel work in rural enterprises. As Denis F. Simon's research has indicated, political cadres see themselves as being displaced by science and technological personnel. Party officials have felt insecure in granting these individuals more authority and

independence, especially since they threaten the party's own claims to be the main purveyor of truth and knowledge in society.<sup>46</sup> Technological personnel are worried about other people criticizing them by saying that their purpose in going down to work in the township and town enterprises is to "make big money". In some cases, these individuals have been accused of extortion and blackmail by jealous individuals who have not had such opportunities available to themselves.<sup>47</sup>

The State plans that by the year 2000 there would be 200 million workers in rural enterprises. It would be very difficult for the enterprises to train this large number of workers by themselves. The official proposal is that 1 per cent of the tax money turned over to the State from rural enterprises, about 2 billion yuan, be used to train workers in rural enterprises. However, this is still not likely to be an adequate solution.

### **8.3.3 Cooperation in Technology**

Before cooperation in technology is discussed, it is necessary to give a brief description of the system of China's science and technology. An unreformed Soviet system of science and technology structure, which operated in China until the late seventies, was unsuccessful in providing a sufficient, consistent link between the research and productive sectors.<sup>48</sup> Moreover, sources of technology



are different for various parts of the industrial spectrum. Nation- and province- level enterprises receive their technological inputs mainly from national science and technology institutes and through imports. Lower-level enterprises are not completely cut off from these sources, but the bottom of the industrial pyramid derives its technological advancement mainly from a process of internal diffusion. Advanced science and technology are available mainly at higher levels. Intermediate science and technology are available for the middle levels, while the lower levels mainly get technological knowledge from a popular-based extension network.<sup>49</sup> Thus, rural enterprises could only obtained inputs of low technology. If rural enterprises want to obtain advanced technology, it is necessary for them to cooperate with state enterprises, research institutes and universities.

Since 1978, technological cooperation has been encouraged by the Chinese government, as the following statement illustrates:<sup>50</sup> In the past two years, the commune and brigade enterprises in some localities have invited scientists and technicians from various scientific research departments, colleges and institutions of higher training, and designing departments to work as their advisers, assume the task of manufacturing new products on a trial basis, and apply the results from scientific research in production. This practice has helped the enterprises acquire many new techniques and turn out many new products. This has not only

quicken the pace in turning science and technology into an actual productive force and closely linked scientific research with production, but has also solved the problem of weak technological forces in commune and brigade enterprises. Efforts must be made earnestly to sum up and propagate our experience in this respect.<sup>51</sup>

Cooperation efforts between research institutes or universities and rural enterprises and between state enterprises and rural enterprises have gone further. They take varied forms, take place at different levels and develop in different directions.

Transfer of technology is a very common form of cooperation in technology. Both "vertical" and "horizontal" transfers of technology have taken place from foreign countries, research institutes and universities to rural enterprises or from state enterprises to rural enterprises. For example, a knitting mill in Jiangyin County, Jiangsu Province had less than 100 workers before 1981. After cooperating with the Jiangsu Import and Export Company of Knitting Products, and importing advanced foreign technology in 1981, by 1986 the mill produced 29.95 million yuan and earned \$5.6 million foreign exchange. The scale of the mill increased to about 1,000 workers and 6 million yuan of fixed capital in 1987.<sup>52</sup> This form of technology transfer is most suitable for those technologies that are not very sophisticated and can be easily adopted. Research institutes or universities are responsible for furnishing the

enterprise with the technology and solving the problems arising during production, but they do not take part in the management of the enterprise. The transfer of technology to previously non-industrialized areas is a very important part of the policies to promote the development of rural areas and thereby reduce poverty. Localities which have already started their industrialization will continue to be dependent on technology transfer in order to upgrade their industrial capability and move into the manufacture of more complicated products.

In the process of the transfer of technology, big state enterprises in a number of places played a very important role in promoting technological cooperation with rural enterprises. Cooperation between urban state enterprises and rural enterprises takes place in two different forms. On the one hand, state enterprises send personnel and equipment to the places where new rural enterprises are to be set up. On the other hand, technological personnel are trained in state enterprises. For example, in Changsha, Hunan, 49 urban enterprises cooperated with 108 rural factories to manufacture 267 products, increasing the output value to 130m yuan in 1986. The rural enterprises acquired 1,995 technicians, 16.6m yuan and 385 machines through the cooperation, while offering land, labour and profit-sharing with their urban counterparts.<sup>53</sup>



While helping rural enterprises to improve their technology and increase their incomes, urban enterprises have also expanded production and developed new and competitive products through co-operation. For example, Changlegang village in Changsha County used to grow only rice, sweet potatoes and hot peppers in the past while rich deposits of tin ore lay idle nearby. The village and a geological institute in Changsha set up a factory in July 1986. With techniques and equipment provided by the institute, the villages produced 250 tons of finished ore worth 400,000 yuan. After recovery of investment, the village shared profits of 100,000 yuan. The 40 families in the village averaged an additional income of 1,300 yuan. When the provincial embroidery factory lacked female labour in 1985, it signed contracts with a nearby town. The 700 rural women, processing supplied materials in their homes, helped the factory complete export tasks, while earning about 40 yuan per capita each month.<sup>54</sup>

There was also close cooperation between research institutes and universities and rural enterprises. Some research institutes and universities sent their experts to the enterprises to work as technological advisers according to the needs of specific enterprises, thus providing technological advice and services in relation to its production. In addition, research institutes and universities have trained students majoring in subjects requested by rural enterprises, and offer training classes

in business management for factory directors and managers. For example, Liaoning province had developed a project to spread advanced technology through a network involving three counties, 20 townships and 100 villages. The three-year programme was carried out on an experimental bases in Fuxing, Kazuo and Haicheng counties in 1982. The three counties trained more than 226,000 people through 1,100 technology courses between 1983 and 1985.<sup>55</sup> In 1985 some 1,300 experts, technicians and various other types of professional personnel were invited to work in the three counties and 20 townships. They conducted surveys on local natural resources, helped in working out development plans and spread technology by training personnel.<sup>56</sup> The example from Liaoning Province shows that training programs are improving, and in a few cases, the technological expertise in rural enterprises has improved. However, on a national scale, the level of personnel and technology transfer remains relatively low, and is a key impediment to the long term development of an efficient and more productive rural enterprise sector.

Some research institutes and universities also cooperate with rural enterprises to undertake joint research projects. Research institutes or universities provide technology while rural enterprises provide buildings, manpower, capital and other facilities. After the results of one project are put into production, other joint research projects can be planned and arranged according to the need of the

enterprises. As a result, the enterprises are able to develop new products at different times. For example, the three counties mentioned above established ties with over 160 colleges, research units and industrial enterprises to absorb modern technology. The 20 townships achieved good economic results owing to the spread of 233 new technology items in 1985. By the end of October, they had produced a total industrial and agricultural output value of 553.29 million yuan -- a 57.73 % increase over the same period of 1984.<sup>57</sup> Thus, it is a good way to promote the cooperation between rural enterprises and research institutes and universities. In so doing, on the one hand, research institutes and universities can gain funds by providing technology for rural enterprises. On the other hand, rural enterprises can improve technology by cooperating with research institutes and universities.

Some rural enterprises in coastal areas have also started to cooperate with foreign businesses through equity and contractual joint-ventures and other arrangements with overseas Chinese and foreign businesses so that rural enterprises could buy advanced equipment, technologies, craftsmanship, and management skills. For example, Jiangkou town, Putia County, Fujian utilized funds invested by overseas Chinese to import advanced technologies and equipment, and through various joint operation arrangements, it has put its products on the world market. By 1987, there were 1,159 large and small enterprises in the township.<sup>58</sup>



In short, cooperation in technology between state enterprises and rural enterprises, between research institutes or universities and rural enterprises and between foreign businesses and rural enterprises has helped in promoting technological development of rural enterprises as well as improving production in rural enterprises. Nevertheless, the extent of technological collaboration on a national level remains relatively poor. The 'haves' are unwilling to provide advanced technology to the 'have-nots' instead preferring to maintain their advantage over potential competitors. The level of technology being transferred to rural enterprises is typically out-of-date productive capacity discarded by enterprises after they have upgraded their own facilities. The poor level of technological development in the countryside thus remains an important obstacle to future growth in this area, and to the establishment of a more efficient rural industrial sector.

#### **8.4 The Prospects for Technological Progress**

Since 1978, the Chinese government has emphasized the need to improve the technological level of rural enterprises. This policy and its implementation have had important implications for technological progress in rural enterprises. The Spark Plan has played a significant role in promoting relatively large-scale rural enterprises. The increase in the mobility of technological personnel between

research institutes and rural enterprises not only helps to exploit the potential of scarce technological and professional manpower, but also to an extent helps to solve the shortage of technological personnel in rural enterprises. Cooperation in technology has played a very important role in promoting the technological development of rural enterprises.

Although the Chinese government has tried to promote technological progress since 1978, there is still a severe technological problem. At present, obsolete facilities, outdated techniques, and the shortage of qualified personnel, are the major obstacles to improve the quality of products, and reduce raw material consumption. Moreover, rural enterprises are facing new difficulties. Rural enterprises have gradually lost their privileges under the new situation brought on by reforms. The concessionary tax and credit policies originally enjoyed have been gradually cancelled. The advantage of lower paid labour has been greatly reduced. The means of production have seen great price rises. Therefore, if township enterprises are to achieve stability, they must rely on technological progress to increase competitiveness and adaptability. Therefore, technological progress in rural enterprises will be crucial in future.

Achieving technological progress is thus an urgent task for rural enterprises. If rural enterprises want to make technological progress in future, the most important

tasks would be to solve the problems of technological personnel and finance.

Qualified personnel are the key element in achieving technological progress. Rural enterprises have an insatiable need for well-trained personnel, and they are competing for all kinds of technological people with state-enterprises. In order to solve the shortage of qualified personnel, some factories send people to the universities, but few return to work for the plant.

There is another major issue concerning the handling of the technological people who are helping the rural enterprises. Under present conditions, the short cut to finding the personnel to expedite advancements in the technology of rural enterprises is to recruit professionals and technological people to work after hours.

Serious lack of financial resources in China is another important factor explaining low levels of technological capacity in rural enterprises. For rural enterprises, the sources of finance for innovation and production development are from retained profit, depreciation funds and the new product development funds derived from sales. However, the problems of exacting a large percentage of profit, collecting excessive charges, apportioning numbers expenses and allowing the town and township enterprises to retain little profit, and the problem that town and township enterprises lack reserve strength, not only generally exist but are also very



serious. According to a study of some township and town enterprises in Hebei Province in 1986<sup>59</sup>, in the first half of 1986, those enterprises realized after-tax profits of 2.668 million yuan, 49 percent of which was exacted by the township(town) and village authorities. Only 18 percent of the profit exacted by the township (town) and village authorities was returned to the enterprises. When the enterprises' after-tax profit was exacted by the township or village authorities, a lot of enterprises did not have the money to buy new equipment and had to borrow loans to buy raw materials and other essentials for their production.<sup>60</sup> In addition, the investigation showed that those enterprises paid a total of 1.047 million yuan to some departments in various charges and apportionments, which accounted for 23 percent of their sales profits.<sup>61</sup> The main reason is that the functions of government and enterprises have not separated, and local governments have to rely on rural enterprises as their main financial sources.

The educational level of workers in rural enterprises is low. Most farmers were farm workers before they joined rural enterprises. Thus they lack broad and modernized industrial knowledge. Some enterprises believe that a one-time purchase of new facilities would solve a lifetime of problems. Some enterprises randomly pick a product without knowing the market conditions, and blindly produce goods without even considering improving technology as a means of enhancing their ability to compete. Others only eye

immediate profits and are unwilling to invest in new equipment.<sup>62</sup>

Therefore, if the level of technology in rural enterprises is to be significantly improved, both rural enterprises themselves and the Chinese government have much more to do. The measures for the promotion of technology in rural enterprises should include the following aspects: Chinese government should give preferential treatment in fiscal policy and grant rural enterprises more loans to improve outdated equipment and to train workers. Rural enterprises should attract more technological personnel from state enterprises, research institutes and universities, or persuade them to use their spare time to help them improve technology. The rate of depreciation for equipment should be increased so that rural enterprises can upgrade equipment more rapidly and devote efforts to assimilating suitable advance technology.

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23. Xu Yu, "Township Enterprises and Foreign Trade," Beijing, *Guoji Maoyi Wenti*, No 6, 1987, pp. 16-20.

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26. A detailed analysis can be seen in Wang Zhonghui, "Private Enterprises in China: An Overview," *The Journal of Communist Studies*, September 1990.

27. "Opinions on strengthening Product Quality Management Work in Township and Town Industries," *Zhongguo Xiangzhen Qiye Bao* (Chinese Township and Town Daily), 12 Mar 86, P.3.

28. "five things not permitted" : (1) substandard products should not leave the factory nor be included in output or value of output; (2) substandard raw materials and parts cannot be used or assembled; (3) products whose demise has been announced cannot be sold; (4) nothing can be produced if there are no product quality standards, quality-inspection organs or quality-inspection measures; (5) there can be no deception, switching substandard products for good ones, fake labeling or fraudulent brands.

29. "three thing are not permitted": the first is not permitting substandard products to leave the factory, the second is not permitting the production and sale of products that have been eliminated, and the third is not permitting fraud.

30. *People's Republic of China Year Book 1988/89*, edited by Editorial Department of The PRC Year Book, Beijing, 1989.

31. Liu Zhongkui, "Town and township Enterprises and "Spark Plan"," Tianjin, *Jishu Shichang Bao* in Chinese, 4 Feb 86, pp.1-3.

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33. "short, level, and speedy" means that turnaround time for results is short, technology is not conspicuous, and topics are quickly determined, developed, and disseminated. Liu Zhongkui, 'Town and township Enterprises and "Spark

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44. "Town and Township Enterprises in Various Localities Are Accelerating the Cultivation of Capable Personnel and the Introduction of Technology," *Kungfei kuang-po shih-lu*, no. 10597, 10 February 1986, pp.3-4. See also, Chen Te-sheng, "The development of Town and Township Enterprises in Mainland China Since 1979," *Issues and Studies*, Vol.22, No.10, Oct 1986.

45. Nicholas R. Lardy, *Agriculture in China's Modern Economic Development*, Cambridge University Press, 1983, pp.163-164.

46. Denis F. Simon, *op.cit.*, p.142.

47. *ibid.*, see also FBIS-PRC, 20 July 1984, p.3.

48. Tony Saich, *op. cit.*, pp.34-35.

49. Jon Sigurdson, *Rural Industrialization in China*, Harvard University Press, 1977, p.77.

50. The Minister of Agriculture, Animal Husbandry and Fishery and the ministry's leading party group, "Report on Creating a New Situation for Commune and Brigade Enterprises," SWB 26 Mar 84.

51. *ibid.*



52. Yan Yingcong, "Coordinated Development of Urban and Rural Enterprises in South Jiangsu," *Nongye Jingji Wenti (Problems of Agricultural Economy)*, No.11, 1987.
53. SWB/W 5 Feb 86. Xinhua in English 0752 gmt 23 Jan 86.
54. *ibid.*
55. SWB/W, 29 Jan 86, Xinhua in English 0905 gmt 16 Jan 86.
56. *ibid.*
57. *ibid.*
58. Xu Yu, *op.cit.*
59. The investigation obtained from profit distribution in 97 collective enterprises (73 town (township)-run enterprises, and 24 village-run enterprises) in the 10 townships (towns) and 10 villages under the jurisdiction of Handan City. See, "Serious Problems of Small Retained Profits and Inadequate Reserve Strength in Enterprises--Investigation on Profit Distribution in Town and Township Enterprises," *Nongmin Ribao (Peasant Daily)*, 13 Nov 86, p.2.
60. *ibid.*
61. *ibid.*
62. Xiao Lan, "Hope and Fears of Township and Town Industries in the Course of Technological Progress," Beijing, *Jingji Gongzuo Tongxun (Economic Work Bulletin)*, No.21, 15 Nov 86, pp.23-24.



## Chapter 9 Conclusion

### 9.1 Positive Roles of Public Policy changes for Rural Enterprises

When the reformist leadership of Deng Xiaoping assumed power in December 1978, the CCP was facing a crisis of legitimacy. Although there were serious disagreements among the new leadership over the best way forward for China, a consensus developed among the party leadership that policy changes had to occur if the Party was to retain its position and the country was not to slide further behind its competitors in terms of economic development. As Carol Hamrin<sup>1</sup> wrote: "From the beginning, Deng Xiaoping viewed the economic reform program not only as a necessity for national well being, but also as a survival kit for the CCP." It is therefore impossible to separate the economic and political imperatives behind policy changes towards rural enterprises after 1978 - the survival of the CCP was perceived as being dependent on the rapid development of the Chinese economy.

This study has demonstrated that changes in public policy after 1978 did play positive roles in promoting the development of rural enterprises. These positive roles have been manifested in the following areas. First, and of crucial importance, the ideological base of policy has changed from one of restraining the development of

collective rural enterprises before 1978 to encouraging the development of rural enterprises after 1978. Perhaps the most dramatic change occurred in the official attitude towards the private sector of rural enterprises. From being prohibited during the Maoist era, the private sector of rural enterprises was not only tolerated after 1978, but in the case of Wenzhou, has been actively encouraged and promoted as a positive model by some Chinese leaders. Without these fundamental changes of policy, neither political climate would have been conducive to the development of rural enterprises.

Secondly, the extension of more decision-making powers to local governments allowed local governments considerable leeway in formulating policies to aid the development of rural enterprises. As a result, different development approaches have emerged in different areas depending on local regional economic and geographical conditions. As demonstrated in Chapter Three, development strategies in Wenzhou are fundamentally different from those adopted in Southern Jiangsu. As a result, it is not possible to talk in terms of a single development model for rural enterprises. There are large disparities in the scope and nature of developments across China as a whole. These disparities have not only been affected by local development strategies, but have also been influenced by the uneven development programme adopted in the 1980s. In combination, these policy changes have resulted in wide divergences in development,

not only between the three large regions (west, centre and coast) but also within regions.

Thirdly, the expansion of market mechanisms as a means to regulate the economy has facilitated the development of rural enterprises. Freed from the constraints of bureaucratic management and allocation of resources, rural enterprises are able to buy more raw materials and get more funds in free markets. Without this development, the expansion of rural enterprises would have been strictly limited.

But although the introduction of market mechanisms has undoubtedly facilitated the development of rural enterprises, the change from the old system has not been total. The hand of bureaucratic management is still very visible, particularly in the state-run sector. With many products in short supply on the domestic market, the government has frequently intervened to ensure the provision of adequate supplies to large-scale state run enterprises deemed to be essential components of the national economy. In these situations, rural enterprises become squeezed by the government's commitment to the state sector, and find it difficult to gain access to essential raw materials. In essence, when times are good, rural enterprises benefit from the development of the market, but when times get hard, they find themselves at the bottom of the government's pecking order for the allocation of resources. Like most sectors of the Chinese economy, rural enterprises have faced



difficulties due to the partial nature of reform. However on balance, we must conclude that even the partial introduction of the market is more conducive to the development of rural enterprises than no market at all.

Fourthly, in order to solve the problem of huge numbers of rural surplus labourers in rural areas, the government has adopted the development of rural enterprises as the most important strategy in solving rural unemployment since 1978. The government has remained in tight control of peasants' rights to migrate to big cities, but it has adopted a more liberal policy to allow peasants to establish rural enterprises in small towns. This has provided a strong incentive for farmers to develop rural enterprises.

Fifthly, the government has provided collective rural enterprises with preferential treatment in terms of bank credit and tax rates, although state loans towards rural enterprises have decreased since late 1988 and tax rates on rural enterprises have also gradually increased. Since 1978, the implementation of the agricultural output responsibility system and the reforms of agricultural prices have increased peasant incomes. This has enabled rural enterprises to raise funds from individuals and society in various ways. Therefore, government financial and tax policies have created more favourable financial conditions for developing rural enterprises, especially collective rural enterprises.

Sixthly, the government has provided some policies to improve management in rural enterprises, especially in

township or village owned enterprises. The government has implemented the contractual responsibility system and a responsibility system for factory directors. The government also changed the payment system for labour and adopted a policy to promote the quality of production in rural enterprises. As a result, these policies have improved management in rural enterprises.

Seventhly, since 1978 the technological strategy of the government has been changed from an emphasis on small-scale labour-intensive methods of production to the use of appropriate technology. The reform of the science and technology management system has given rural enterprises more opportunities to obtain advanced technology. The government has also taken some practical measures to promote technology in rural enterprises, including the implementation of the "Spark Plan" and the policy to allow technological personnel to work in rural enterprises in their spare time and the promotion of cooperation in technology between state enterprises and rural enterprises and between research institutes and universities and rural enterprises. These measures have also promoted technology in rural enterprises.

## **9.2 Remaining Problems for Rural Enterprises**

The changes outlined above have combined to create an economic and political environment that has facilitated the

development of rural enterprises. But despite these advances, the change of public policy has been inadequate. On the long march to the situation where rural enterprises can play a full and valuable role in the Chinese economy, there is still a long way to go.

Although private enterprises have acquired a legal status, private enterprises still face many difficulties and different forms of discrimination. Similarly, there is still considerable discrimination against rural enterprises (whether they are collective-run or private-run enterprises) particularly in the supply of raw materials and credits, compared with the policy towards state-run enterprises.

Since 1978, the reform of the market has created a more favourable market environment for the development of rural enterprises. However, rural enterprises have not enjoyed the same competitive position as state-enterprise in many areas such as product transport, retailing and export, and the supply of key production elements. With the further reform of the economic system in the cities, the large and medium state enterprises have taken further steps to relax restrictions in order to invigorate their operations. At the same time, however, some privileges of state enterprises remain. In addition, with the increase in the level of wages and benefits for staff workers, the cost of labour in rural areas has increased. With the gradual opening of the market, the prices of energy and raw materials have continued to rise, so that rural enterprises have paid higher costs. With



the intensification of competition in the market, increasingly higher demands have also been made of rural enterprises in the technical standard and quality of their products. Thus, situations where rural enterprises enjoyed a position of superiority, normally or abnormally, have already, and I would argue prematurely, begun to fade away. In addition, the preferential treatments in credit and taxes formerly accorded rural enterprises have gradually been reduced.

If the benefits of the introduction of market mechanisms have been tempered, so the devolution of powers to local authorities has been a double edged sword. The shortage of fiscal income in local communities and local government funds for welfare work and agricultural funds has led to the problem of local government exacting a large percentage of profit, and collecting excessive charges. Although the central government has implemented a policy of reducing the financial burden of rural enterprises, some problems such as exacting a large percentage of profits, collecting excessive charges, and allowing rural enterprises to retain only a small percentage of profits have remained.

Government policies to promote technology in rural enterprises have also been inadequate. The shortage of technological personnel and finance and the low educational level of workers remain formidable obstacles for the future progress of technology in rural enterprises.

Moreover, some political and ideological questions have remained an obstacle restraining rural enterprises to make even greater progress. One complaint against rural enterprises has been that the development of rural enterprises affected agricultural production. For example, addressing the CCP's National Conference of Delegates in September 1985, Chen Yun asserted that:

"Township and town enterprises should be developed, but the problem is that the call of 'no prosperity without engaging in industry' is heard much louder than that of 'no economic stability without agricultural development.' Feeding and clothing a billion people constitutes one of China's major political as well as economic challenges, because grain shortages will lead to social disorder.' We cannot afford to underestimate this matter."<sup>2</sup>

The adoption of the contract responsibility system unleashed the productive capabilities of the agricultural sector; agricultural income rose as a result of adjustment and decontrol of some agricultural product prices. However, agriculture in China remains backward, a fact borne out by the fluctuating agricultural production figures.

The rapid development of rural enterprises has widened the discrepancy between the income of rural enterprises workers and peasants; hence, a problem involving agricultural production has arisen. According to a study

conducted in Southern Jiangsu Province, peasants are unwilling to stop planting grain, but they are also unwilling to plant too much. They do not want to stop planting because their past experience of hunger urges them not to abandon grain production. They do not want to plant too much because the economic results of land cultivation is about 30 percent lower than that of industrial work.<sup>3</sup> This has caused considerable waste of farmland. In addition, large tracts of farmland have been occupied by flourishing rural enterprises. These two factors have contributed to a sharp decrease in farmland in recent years. Thus, the state should control the use of land, and rural enterprises should be concentrated in small towns so that the use of farmland could be more efficient.

However, the problems of agriculture should not be blamed entirely on the development of rural enterprises. On the contrary, rural enterprises have supported the development of agriculture with a large amounts of funds. For example, in 1989, Zhejiang and Shanghai on average received 200 to 300 yuan per person per year in "supplementing agriculture" money.<sup>4</sup> According to a survey conducted in coastal areas, each county needs more than 100 million yuan (\$18.5 million) to reach the goal of agricultural modernization. A substantial part of this large amount of investment has to be provided by rural industry.<sup>5</sup> This suggests that the view that rural enterprises had caused the agricultural decline is unjustified.



Another complaint against rural enterprises has been that rural enterprises have polluted the environment. A study was published in 1988 by environmentalists and ecologists from the Chinese scientific and other research institutions<sup>6</sup>, pointed out that the most flourishing rural industries were built without any consideration for the environment since 1978. In a report on environmental problems caused by China's small town and village industries, the scientists predicted that if rural enterprises continue to increase at a 25 to 30 percent growth rate, their industrial waste water will account for 40 to 50 percent of country's total by the year 2,000. A test of the atmosphere in seven provinces where 12,000 rural enterprises are located showed that the content of toxicant elements in the air, such as benzene, silicon dust and asbestos, surpassed the standards set forth by the state public health authorities by several hundred or even one thousand times.<sup>7</sup> The waste water coming from rural industries accounted for only 10 percent of the country's total industrial waste water release, but in some highly-developed areas such as Southern Jiangsu province, industrial population in surrounding rural townships has been large-scale. Moreover, areas specializing in the production of sulphur, coke, bricks and tiles have had serious effect on the atmosphere, though large-scale air pollution has not been detected.<sup>8</sup>

Thus, environmental problems should be considered when rural enterprises are established. China's environmental protection policies should in future pay greater attention to rural ecological environment even though its priority may remain focused on urban areas.

Private enterprises were only officially legalized in 1988, and have traditionally been considered "capitalist ownership". As a result, political and ideological problems for private enterprises have been more severe. Some local party leaders have expressed concern that the existence and development of private enterprises might lead to private entrepreneurs becoming a distinct class infiltrating the state sector. This could result in the "restoration of capitalism", which would change the face of socialism and the nature of society in China.<sup>9</sup>

However, whether the economic reform policies will bring about fundamental changes in the political system will depend largely on whether the private sector of the economy can become strong enough to account for a significant part of China's gross national product. The output value of the private economy still only accounts for a very low percentage of the gross output value of Chinese industry. Nonetheless, the newly risen entrepreneurs with their increased wealth and social influence have brought demands for political influence and social standing.

It was reported that more than 200,000 members of the Chinese Communist Party engaged in the private sector of

the economy in early 1989.<sup>10</sup> Among the entrepreneurs in the survey of private rural enterprises,<sup>11</sup> 21.6% were members of the Communist Party of China, 6.2% were members of the Communist Youth League of China, 8.2% held positions in Village CCP Committees and Village Committees, 15.5% had relatives who worked in the government of the town (township) or county, or other public organizations. This data suggests that entrepreneurs have certain influence in rural areas. Potentially more damaging for the CCP in the long run, it also suggests that party membership, or links with party members, can ease the process of establishing and running private enterprises. The popular suspicion that private enterprises go hand in hand with corruption is unlikely to be eased by such a relationship. Thus, it could be said that the private economy is already playing a considerable role in Chinese politics.

Furthermore, the working conditions for employees in enterprises owned by party members is not in accord with the party constitution, which calls for its members to make concerted efforts to eliminate exploitation in China.<sup>12</sup> It has been argued that if these members do not use all their income from exploitation for investment, the improvement of people's well-being and Party members dues, or if their enterprises are not transformed into collective enterprises, these members should be asked to quit the Party.<sup>13</sup> Although these employment practices have been justified as a means to achieve common prosperity and the development of a



commodity economy, this does confuse the ideology of the members of the CCP. With the development of private enterprises in China, criticisms of the connection between party membership and private ownership of enterprises will continue to be expressed.

As noted above, the main public complaint against private enterprises is in terms of corruption and illegal practices. As I have demonstrated in section 6.2 of Chapter Six, large numbers of rural enterprises have been guilty of tax evasion. In addition, the highly monopolized financial organizations have made it very hard for private enterprises to obtain loans, which sometimes are only available with "good personal connections". Thus private businesses have been forced to depend on favours and gifts in order to obtain raw materials, sell their goods and raise loans. It could therefore be argued that any corruption that arises is the fault of the partial nature of reform, which allows private enterprises to legally exist, but does not allow them to get what they physically need to exist. Nevertheless, in the eyes of much of the population, corruption is still being blamed on the existence of private enterprises, and not the economic system that they are forced to exist in.

The development of private enterprises has widened disparities between the rich and the poor and between different regions. The result has been an increase in social tension. For example, in a survey of 100 private rural

enterprises, the average initial capital of each enterprise was 32,000 yuan. After three to four years, the average capital of each enterprise reached 144,000 yuan.<sup>14</sup> Furthermore, most private enterprises have operated in more developed rural areas along the coast.<sup>15</sup> By contrast, some areas hindered by poor geographical conditions, conservative views, and a low level of education, have not solved problems of poverty and backwardness. In addition, some entrepreneurs have articulated the fear that government officials may find ways to reorganize their businesses in the future. Thus, wealthy entrepreneurs in some areas have hit on the idea of making gifts of money, and providing other favours to cadres in the hopes of averting future problems.<sup>16</sup>

In the past, China condemned the capitalist theory. However, now it has admitted that a private economy in China can promote production, provide employment opportunities, and help in many other ways to meet people's needs. Thus, traditional Marxist-Leninist ideology has not guided present policy. Some theoreticians have tried to find new theories to explain the problem of the emergence of new economic and social forces. They have argued that China must comprehensively and correctly reassess modern capitalism - especially capitalism since World War II - and have called for the assimilation of the positive aspects and achievements of capitalism.

In the meanwhile, however, the development and existence of the private sector has brought it into competition with public ownership of the economic system. On the one hand, this competition could improve the administration and management of public ownership, as well as raising the quality of services within the state and collective systems. On the other hand, the very rapid development of private enterprises has caused state run businesses severe difficulties. Thus, the superiority of state ownership has been brought into doubt.

For example, Wenzhou has a proportionately bigger private economy than anywhere else in China. In Wenzhou, state run businesses which have been managed over the past thirty years have been surpassed by private companies which have developed in a mere three to five years. Traditional management ideas and methods used by state run businesses have been decimated by furious competition and are left no choice but to undergo whole scale revision. Three economists at the Chinese Academy of Social Sciences made the strongest case for a reform policy based on attacking state ownership and gave a plan for "privatising China".<sup>17</sup> After the events of 4 June 1989, the plan of privatising China has officially been denied.<sup>18</sup> Although this proposal has, for the time being, been rejected by the Chinese government, it is possible that the proportion of public ownership will continue to fall in the future.



Private enterprises were among the hardest hit during the national austerity programme implemented between 1988 and 1991. According to the State Administration of Industry and Commerce, more than 1 million self-employed people across the country went out of business in the first few months of 1989. Not only were many existing private businesses closing, but the number of new self-employed households registering was also declining.<sup>19</sup> The main reason behind the decrease was that of the state's rectification of private businesses.<sup>20</sup>

Another reason for the decline was the impact of the austerity programmes launched in September 1988. According to Wang Zhongming, director of the administration's Individual and Private Economy department, these programmes decreased the amount of bank loans, raw materials, fuel and other resources available to private businesses. For example, in Wenzhou, local banks did not allow individual businessmen to withdraw money, resulting in about 300,000 businessmen and their partners reaching the verge of bankruptcy.<sup>21</sup> Other factors included poor management, indiscriminate fines and fees, extortion and fund shortages.

In summary, although the legal status of private enterprises changed in the 1980s, much work remains to be done before they can compete in an equable manner in the Chinese economy. The crucial factor is the continued existence of a political and ideological environment that fosters suspicion (and even downright hostility) to the

private sector. Unless and until this environment changes, then private enterprises will not be able to operate to their full capacity, and the long term development of the Chinese economy will be subsequently hampered.

### **9.3 Prospects for The Future Development of Rural Enterprises**

Although some political and ideological problems remain to be solved, it is reasonably certain that the Chinese government will continue to permit, and even encourage the development of rural enterprises. China's leaders are aware that farmers cannot rely on the limited arable land to improve their living standards. Moreover, agricultural modernization and the improvement of rural communication and transport services depends on the development of rural enterprises since the government cannot invest much money for agriculture when poorly run state owned industries, regarded as the backbone of the national economy, constantly need more money themselves.

Moreover, China will have 520 million rural labourers by the end of this century, but agriculture can absorb only 200 million farmers, and urban areas can accommodate no more than 20 million rural people.<sup>22</sup> The rest will have to rely on rural enterprises. The alternative is to allow a large disaffected rural sector to develop - which, as the CCP's

own rise to power proved, may not prove conducive to the party's desire to keep a grip on political power.

The signs are that the CCP is prepared to promote the development of rural enterprises as a strategy for absorbing surplus rural labour. In particular, the "Decision of the CCP Central Committee on Further Strengthening Agriculture and the Work in Rural Areas", adopted by the eighth plenary session of the 13th CCP Central Committee on 29th November 1991, is worthy of attention. The Central Committee called for the development of secondary and tertiary industries, the stepping up of the development of small rural industrial districts and market towns, and the opening up of more avenues for rural labour force transfer.<sup>23</sup> In the light of this decision, it seems clear that the development of rural enterprises will be the single most important government strategy for utilising rural surplus labour.

Even during the austerity programme of late 1988 to 1991, new policies affecting rural enterprises were still formulated. In 1990, for example, the "Regulations for Collective rural enterprises in the PRC" was passed. The "Decision of the CCP Central Committee on Further Strengthening Agriculture and the Work in Rural Areas", adopted by the eighth plenary session of the 13th CCP Central Committee on 29th November 1991, also indicated that actively developing township and town enterprises is considered to be the way to develop the rural economy, and to increase peasants' income, and to speed up agricultural



modernization and national economic development.<sup>24</sup> The decision further called for the giving of active support to township and town enterprises.

The current government leaders' attitude towards rural enterprises is different from that epitomised by former premier and party secretary general Zhao Ziyang. They have emphasized the key function to be played by state-run large and medium-sized enterprises and adopted a policy that is more definitely inclined to allowing them to acquire capital, energy, and raw materials. However, rural enterprises have already grown bigger and stronger, making the clampdown in favour of state firms that much harder to impose and maintain.

Irrespective of whether China's leaders like rural enterprises or not, most of them have expressed their support for rural enterprises. Deng Xiaoping highly praised these enterprises as a new force that has suddenly come to the fore because of rural reform.<sup>25</sup> Party secretary general Jiang Zemin has similarly stated that the role of township-town enterprises not only lies in having industry nourish both agricultural and sideline production, but also lies in close ties with urban large-scale industry and foreign trade, as well as close ties with agricultural and nonstaple food production.<sup>26</sup> The current prime minister, Li Peng, not noted for his admiration of market forces also stated that:

"In my opinion, we should correctly assess the role that can be played by town and village enterprises in developing China's economy."<sup>27</sup>

The government does not wish the development of private enterprises to threaten the predominance of state enterprises. However, at least with regard to the contribution of private enterprises towards the employment of surplus labour, the Chinese government is willing to tolerate the development of private enterprises. According to official statistics in 1989, private enterprises have employed some four million jobless people, including the disabled whom state enterprises are not willing to employ. If China's private enterprises can be allowed to develop smoothly, their output will make up 10 percent of the national gross value of industrial output and solve the problem of 40 millions jobless people.<sup>28</sup>

At a press conference on 26 September 1989, the answers given by top party leaders confirmed that the Chinese government will permit the continued development of private enterprises. Yao Yilin said that China will continue to encourage their positive role in contributing to the national economy and people's livelihood, and will bring into full play their role as a necessary and beneficial supplement to the socialist economy. On the other hand, China will restrict their negative role by using appropriate industrial and taxation policies to restrict their 'blindness'<sup>29</sup> and strengthen administration and guidance.<sup>30</sup>

Yao Yilin's comments are indicative of the dilemma facing China's leaders. On the one hand, the Chinese leadership has accepted that the development of private enterprises can be beneficial for the current Chinese economy in solving unemployment and improving people's livelihood. On the other hand, the leadership does not want private enterprise to compete seriously with state enterprises and affect the predominant status of public ownership in the Chinese national economy. But on balance, it is clear that the current Chinese leadership considers the urgent solution of serious economic problems more important than rigid adherence to Marxist dogmas.

As demonstrated in section 2.1.2 of Chapter Two, important remarks made by Deng Xiaoping during a tour to the south of China, and also at the Fifth Session of the Seventh National People's Congress both called for further economic reform in early 1992. Some important policies have already been formulated to further encourage the development of rural enterprises. It therefore seems beyond any doubt that rural enterprises will continue to develop.

The question is now to what extent this development will go. Some critics have warned against too rapid development of these enterprises, seeing them as a threat to state owned enterprises.<sup>31</sup> When conservative leaders dominated the central government during the period of austerity, they intended to control the annual growth rate of rural enterprises to about 15 percent.<sup>32</sup> However, on one



estimate, if rural enterprises grow at an average of 15 percent a year during the 1990s, they will still increase to a production value of 3.8 trillion yuan (\$704 billion) by the year 2000 and account for 48.3 percent of China's gross social output.<sup>33</sup> Even though they have been the main target of economic retrenchment since late 1988, rural enterprises in 1991 still increased at a rate of 18 percent.<sup>34</sup> Such a dynamic situation suggest that rural enterprises are likely to grow at even higher rates.

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3. Chou Yuan and Chao Ming, "Agriculture in Southern Jiangsu After the Development of Township and Town Enterprises," *Liaowang*, 1985, no.29, p.24.
4. Su Bei, *The Township Enterprises, Where Are They Heading For?* Banyue Tan(Semi-Monthly Talks), No.19, 10 Oct 1989, pp.32-34.
5. "Rural Industry Gives Boost to Nation's Economy," *China Daily*, February 25, 1992.
6. "Polluting Industries Endanger Rural Areas," *China Daily*, Oct 13, 1988.
7. *ibid.*
8. *ibid.*
9. "To See the Economic Trend of Private Economy From Wenzhou," *Liaowang*, Vol.4, 1988, pp.12-14.
10. *Dagong Bao*(*Dagong Daily*), 16 March 1989. This means that on average one out of 235 members of the CCP was involved in the private sector of economy in early 1989.
11. "Dui baijia nongcun siying qiye diaocha de chubu fenxi'(An Initial Analysis of the Survey of 100 Private rural enterprises)," *Nongye Jingji Wenti*(Problems of Agricultural Economy), No.2, 1989 (Monthly), pp.18-23.
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21. Chen Xiao, "Private Businesses Have a Bright Future," *China Daily*, 3 January 1989.
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24. SWB/FE, 3 January 1992.
25. Zhongguo Xiangzhen Qiye Bao(China Township and Village Daily), 13 Feb 1991.
26. ibid.
27. "Township and town enterprises must continue to forge ahead in the course of improving the economic environment and rectifying the economic order and deepening reform," qiushi(Seeking Truth), no.6, 16 Mar 90 pp.6-9.
28. SWB/FE/WER, 24 May 89, Xinhua in English 0104 gmt 12 May 1989.
29. "blindness" means the development of private enterprise without the state planning.
30. "Top Party Leaders Answer Questions at Press Conference," Beijing Review, Vol.32, No.40, 2-8 October 1989, p.16.
31. ibid.
32. SWB/FE, 28 Mar 1990.
33. "Rural firms Seen as Solution to Many Problems," China Daily, February 17, 1992.
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**Appendix 1. A Comparison of Employment in Village-run and Township-run industries in 1987      Unit: 10,000 persons**

	Village Enterprises	Township Enterprises
Total	1735.21	1433.13
Light Industry--	787.47	667.33
Heavy Industry---	947.74	765.80
Branch of Industry		
Coal mining and dressing---	65.29	75.75
Ferrous metals mining and dressing----	9.47	9.07
Non-ferrous metals mining and dressing---	6.98	10.07
Building materials and other non-metal mineral products---	93.21	52.72
Salt mining---	2.69	3.13
Other mining and dressing---	1.34	0.13
Logging and transport of timber and bamboo---	5.21	1.82
Production and supply of running water---	0.12	0.97
Food manufacture---	116.72	62.39
Beverage manufacture---	20.17	26.11
Tobacco processing---	0.27	0.40
Forage Processing---	3.65	2.41
Textiles---	104.88	168.64
Clothing ---	65.94	61.19
Leather, furs and manufactured goods---	29.98	24.46
Timber processing and bamboo, cane, palm fibre and straw products---	29.30	20.38
Furniture manufacture--	19.04	19.44
Paper-making and manufactured goods---	42.45	32.45

Printing---	18.58	11.69
Manufacture of articles for culture, education and sports---	13.20	14.60
Manufacture of articles for arts and crafts---	73.13	59.68
Production and supply of power generation, Steam and hot water---	2.99	10.31
Petroleum processing---	1.22	1.31
Caking, gas and coal-related products--	3.10	3.37
Chemical industry---	37.00	40.07
Medical and pharmaceutic industry---	2.02	4.32
Chemical fibres industry---	1.36	2.66
Rubber manufactured goods---	10.73	10.68
Plastic manufactured goods---	61.75	39.26
Manufactured goods of building materials and other non-metal minerals---	478.80	333.28
Smelting and pressing of ferrous metals---	13.92	14.97
Smelting and pressing of non-ferrous metals--	7.76	6.96
Metal products---	94.91	84.91
Machine building industry---	128.16	132.80
Transportation equipment manufacture--	13.13	19.92
Electric equipment and machinery---	28.91	39.57
Electronic and telecommunications equipment---	11.56	12.55
Instruments, meters and other measuring equipment---	4.06	5.32
Other---	112.31	13.35

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Source: *Statistical Yearbook of China 1988* (Chinese Edition)  
Compiled by the State Statistical Bureau, PRC. Chinese  
Statistical Press, August 1988, p.288  
Note: These statistics are for the township and village  
levels.

**Appendix 2. A Comparison of Technological Personnel per 1000 workers at the end of 1985 between Sample Large and Medium sized Enterprises and Sample Rural Industrial Enterprises**

	Large and Medium Sized Enterprises	Rural Industrial Enterprises
Total	50.49	6.45
Light Industry--	30.57	5.63
Using Farm Products		
As Raw Materials---	22.99	5.16
Using Non-farm Products		
As Raw Materials---	48.97	6.60
Heavy Industry---	57.24	7.09
Excavating---	27.33	4.55
Raw materials---	53.74	9.11
Processing---	77.98	7.51
Branch of Industry		
Coal mining		
and dressing---	19.41	6.47
Ferrous metals		
mining and		
dressing----	34.70	1.65
Non-ferrous		
metals mining		
and dressing---	39.91	4.14
Building materials		
and other		
non-metal mineral		
products---	28.51	2.27
Salt mining---	18.95	4.11
Logging and		
transport of timber		
and bamboo---	33.64	1.06
Production and		
supply of		
running water---	39.49	2.42
Food manufacture---	23.04	6.64
Beverage manufacture---	31.27	10.19
Tobacco processing---	15.09	1.57
Forage Processing---	31.97	8.05
Textiles---	21.27	3.86
Clothing ---	23.81	4.47
Leather, furs and		
manufactured goods---	18.68	5.09
Timber processing		
and bamboo, cane,		
palm fibre and		
straw products---	29.08	4.25
Furniture manufacture--	21.53	4.83



Paper-making and manufactured goods---	30.01	5.83
Printing---	14.44	8.08
Manufacture of articles for culture, education and sports---	52.38	4.33
Manufacture of articles for arts and crafts---	14.22	4.84
Production and supply of power generation, Steam and hot water---	70.45	9.28
Petroleum processing---	78.08	12.68
Caking, gas and coal-related products--	42.79	3.22
Chemical industry---	59.56	10.66
Medical and pharmaceuti cals industry---	74.17	12.74
Chemical fibres industry---	57.92	7.22
Rubber manufactured goods---	40.29	7.17
Plastic manufactured goods---	41.22	5.07
Manufactured goods of building materials and other non-metal minerals---	34.09	5.12
Smelting and pressing of ferrous metals---	45.57	10.22
Smelting and pressing of non-ferrous metals--	43.93	7.87
Metal products---	47.10	8.47
Machine building industry---	72.06	11.65
Transportation equipment manufacture--	84.21	14.32
Electric equipment and machinery---	74.81	9.44
Electronic and telecommunications equipment---	124.10	11.99
Instruments, meters and other measuring equipment---	122.19	11.61
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Source:

Calculated from State Industry Survey Office, the State Council, *The Survey Materials of Industry in 1985 in the People's Republic of China*, Chinese Statistical Press, Beijing, Vol.1, April 1987 and Vol.7, April 1988.

**Appendix 3. A Comparison of Original Value of Fixed Assets per worker engaged at the end of 1985 between Sample Large and Medium sized Enterprises and Sample Rural Industrial Enterprises**

	Large and Medium Sized Enterprises	Rural Industrial Enterprises
Total	20623.18	3099.05
Light Industry--	12666.15	2661.46
Using Farm Products		
As Raw Materials---	10847.51	2669.96
Using Non-farm Products		
As Raw Materials---	17077.57	2643.57
Heavy Industry---	23320.84	3440.97
Excavating---	20269.97	2002.39
Raw materials---	39726.10	7340.85
Processing---	15508.51	3108.98
Branch of Industry		
Coal mining and dressing---	15016.26	2384.62
Ferrous metals mining and dressing---	19860.66	1270.39
Non-ferrous metals mining and dressing---	20712.98	2387.20
Building materials and other non-metal mineral products---	16049.15	1497.92
Salt mining---	12118.11	5058.19
Logging and transport of timber and bamboo---	10037.43	1473.67
Production and supply of running water---	49866.86	10214.58
Food manufacture---	14126.60	4136.92
Beverage manufacture---	15541.83	4669.26
Tobacco processing---	10620.01	1778.91
Forage Processing---	41047.86	4437.57
Textiles---	8584.34	2723.24
Clothing ---	7886.61	1148.99
Leather, furs and manufactured goods---	9888.63	1213.87
Timber processing and bamboo, cane, palm fibre and		

straw products---	11301.70	2531.68
Furniture manufacture--	9319.97	1939.00
Paper-making and manufactured goods---	17482.64	4466.69
Printing---	14684.72	2517.68
Manufacture of articles for culture, education and sports---	15475.01	1967.82
Manufacture of articles for arts and crafts---	7190.19	886.31
Production and supply of power generation, Steam and hot water---	99422.54	24454.54
Petroleum processing---	51467.28	4862.43
Caking, gas and coal-related products--	25886.95	1865.24
Chemical industry---	27743.07	4522.44
Medical and pharmaceuti industry---	13960.78	4103.75
Chemical fibres industry---	42919.45	6294.65
Rubber manufactured goods---	11950.50	3039.65
Plastic manufactured goods---	18490.97	2832.23
Manufactured goods of building materials and other non-metal minerals---	16026.27	3105.73
Smelting and pressing of ferous metals---	26191.49	5120.79
Smelting and pressing of non-ferous metals--	28109.79	4075.30
Metal products---	11773.88	3206.35
Machine building industry---	14362.30	3788.83
Transportation equipment manufacture--	15453.89	3528.73
Electric equipment and machinery---	12159.13	2803.04
Electronic and telecommunications equipment---	14201.09	2527.41
Instruments, meters and other measuring equipment---	12866.22	2522.69
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Note:

Unit = yuan

Source:

As in appendix 1.



**Appendix 4. A Comparison of Net Value of Output per worker  
(Average for Year) in 1985 between Sample Large and Medium  
Sized Enterprises and Sample Rural Industrial Enterprises**

	Large and Medium Sized Enterprises	Rural Industrial Enterprises
Total	7044	2202
Light Industry--	8317	2121
Using Farm Products		
As Raw Materials---	8123	1995
Using Non-farm Products		
As Raw Materials---	8772	2381
Heavy Industry---	6621	2262
Excavating---	4766	1990
Raw materials---	11502	2754
Processing---	4897	2252
Branch of Industry		
Coal mining		
and dressing---	1877	1999
Ferrous metals		
mining and		
dressing----	3736	1953
Non-ferrous		
metals mining		
and dressing---	2937	2529
Building materials		
and other		
non-metal mineral		
products---	2319	1855
Salt mining---	7541	3034
Logging and		
transport of timber		
and bamboo---	3034	4164
Production and		
supply of		
running water---	5386	2624
Food manufacture---	5285	1652
Beverage manufacture---	9746	2691
Tobacco processing---	66499	2066
Forage Processing---	12704	2070
Textiles---	5113	2383
Clothing ---	4538	1699
Leather, furs and		
manufactured goods---	4253	1711
Timber processing		
and bamboo, cane,		
palm fibre and		
straw products---	3684	1760

Furniture manufacture--	4102	1749
Paper-making and		
manufactured goods---	6791	1955
Printing---	6002	1977
Manufacture of articles		
for culture,		
education and sports---	11893	1876
Manufacture of articles		
for arts and crafts---	3639	1470
Production and supply		
of power generation,		
Steam and hot water---	20292	2136
Petroleum processing---	44698	4934
Caking, gas and		
coal-related products--	4672	1763
Chemical industry---	8387	3031
Medical and pharmaceuti		
industry---	7700	3526
Chemical fibres		
industry---	12697	4244
Rubber manufactured		
goods---	12627	3053
Plastic manufactured		
goods---	7573	2272
Manufactured goods		
of building materials		
and other non-metal		
minerals---	5118	1720
Smelting and pressing		
of ferrous metals---	7492	3795
Smelting and pressing		
of non-ferrous metals--	6624	4215
Metal products---	5365	2394
Machine building		
industry---	4321	3036
Transportation		
equipment manufacture--	5081	3509
Electric equipment		
and machinery---	7684	3980
Electronic and		
telecommunications		
equipment---	6981	3663
Instruments,		
meters and other		
measuring equipment---	4183	2981
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Note:  
Unit = yuan  
Source:  
As in appendix 1.

# Appendix 5. The Investment of Fixed Assets in Sample Rural Industrial Enterprises

	(1) 1981-1985	(2) 1949-1985	(1) / (2) %
Total	25,016,211	38,127,720	65.61
Light Industry--	10,168,962	14,312,067	71.05
Using Farm Products			
As Raw Materials---	7,195,302	9,668,413	74.42
Using Non-farm Products			
As Raw Materials---	2,973,660	4,643,654	64.03
Heavy Industry---	14,847,249	23,815,653	62.34
Excavating---	1,968,099	2,944,157	66.85
Raw materials---	4,386,892	6,654,856	65.92
Processing---	8,492,258	14,216,640	59.73
Branch of Industry			
Coal mining			
and dressing---	1,264,552	1,852,779	68.25
Ferrous metals			
mining and			
dressing----	61,664	84,359	73.09
Non-ferrous			
metals mining			
and dressing---	128,768	188,207	68.42
Building materials			
and other			
non-metal mineral			
products---	500,298	801,532	62.42
Salt mining---	65,782	143,015	45.99
Logging and			
transport of timber			
and bamboo---	12,188	15,930	76.51
Production and			
supply of			
running water---	68,120	78,059	87.21
Food manufacture---	1,540,599	2,259,147	68.19
Beverage manufacture---	717,483	915,704	78.35
Tobacco processing---	1,850	3,377	54.78
Forage Processing---	51,765	60,746	85.22
Textiles---	2,744,820	3,392,958	80.89
Clothing ---	593,644	708,523	83.79
Leather, furs and			
manufactured goods---	184,848	235,632	78.45
Timber processing			
and bamboo, cane,			
palm fibre and			
straw products---	273,717	435,304	62.88



Furniture manufacture--	234,792	374,419	62.71
Paper-making and manufactured goods---	700,663	1,100,103	63.69
Printing---	189,357	250,042	75.73
Manufacture of articles for culture, education and sports---	122,783	154,286	79.58
Manufacture of articles for arts and crafts---	271,591	351,642	77.24
Production and supply of power generation, Steam and hot water---	1,310,134	2,481,910	52.79
Petroleum processing---	28,637	38,464	74.45
Caking, gas and coal-related products--	36,493	49,908	73.12
Chemical industry---	931,736	1,376,430	67.69
Medical and pharmaceuti industry---	88,605	125,835	70.41
Chemical fibres industry---	113,639	119,232	95.31
Rubber manufactured goods---	162,944	241,244	67.54
Plastic manufactured goods---	760,808	986,789	77.09
Manufactured goods of building materials and other non-metal minerals---	6,227,642	9,365,128	66.49
Smelting and pressing of ferrous metals---	468,606	577,522	81.14
Smelting and pressing of non-ferrous metals--	148,789	185,578	80.18
Metal products---	1,276,290	2,463,615	51.81
Machine building industry---	2,224,937	4,519,122	49.23
Transportation equipment manufacture--	432,930	693,334	62.44
Electric equipment and machinery---	645,989	929,252	69.52
Electronic and telecommunications equipment---	167,841	205,681	81.60
Instruments, meters and other measuring equipment---	88,294	130,989	67.41
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Note: Unit = 1,000 yuan  
Source: State Industry Survey Office, the State Council, *The Survey Materials of Industry in 1985 in the People's Republic of China*, Chinese Statistical Press, Beijing, Vol.7, April 1988, pp.150-151.

**Appendix 6. The Size and Acquisition date of Installed Equipment by Original Value at the End of 1985 in Sample Rural Industrial Enterprises by Branch of Industry**

	No. of Enterprises	Total Equipment	80's	70's
Total	170,364	16,089,648	9,830,946	5,594,215
Light Industry	85,849	5,814,586	3,929,367	1,590,605
--Using Farm Products As Raw Materials---	60,350	3,959,368	2,793,383	955,779
--Using Non-farm Products As Raw Materials---	25,499	1,855,218	1,135,984	634,826
Heavy Industry	84,515	10,275,062	5,901,579	4,003,610
Excavating	14,268	910,622	587,371	294,531
Raw materials	15,088	2,777,057	1,565,030	1,120,166
Processing	55,159	6,587,383	3,749,178	2,588,913
Branch of Industry				
Coal mining and dressing---	6,218	488,740	322,907	152,906
Ferrous metals mining and dressing----	677	33,070	21,326	10,398
Non-ferrous metals mining and dressing---	775	77,291	49,836	25,375
Building materials and other non-metal mineral products---	6,386	308,473	191,307	104,862
Salt mining---	384	12,533	5,695	6,194
Logging and transport of timber and bamboo---	199	2,703	1,822	819
Production and supply of running water---	455	7,127	5,262	1,647
Food manufacture---	18,849	736,412	505,184	198,736
Beverage manufacture---	7,779	277,835	211,931	62,015
Tobacco processing---	23	795	383	370
Forage Processing---	975	22,743	17,851	4,515
Textiles---	7,768	1,706,936	1,299,158	282,566
Clothing ---	6,698	277,562	213,339	57,080
Leather, furs and manufactured goods---	2,297	72,720	55,821	14,882
Timber processing and bamboo, cane,				

palm fibre and straw products---	5,171	151,749	88,536	55,941
Furniture manufacture--	5,105	106,535	57,348	42,946
Paper-making and manufactured goods---	3,557	540,087	288,909	230,525
Printing---	2,158	123,441	86,127	29,101
Manufacture of articles for culture, education and sports---	1,016	67,431	46,176	19,284
Manufacture of articles for arts and crafts---	3,568	66,747	47,345	17,215
Production and supply of power generation, Steam and hot water---	6,517	1,019,889	383,285	588,267
Petroleum processing---	160	13,061	7,564	5,347
Caking, gas and coal-related products---	724	15,707	11,360	4,122
Chemical industry---	4,955	481,235	312,482	158,880
Medical and pharmaceutical industry---	363	37,222	27,968	8,441
Chemical fibres industry---	103	71,727	60,165	10,058
Rubber manufactured goods---	996	104,351	65,734	32,765
Plastic manufactured goods---	4,641	518,631	385,564	115,503
Manufactured goods of building materials and other non-metal minerals---	32,378	4,488,811	2,867,137	1,518,231
Smelting and pressing of ferrous metals---	881	293,039	209,027	70,762
Smelting and pressing of non-ferrous metals---	534	86,349	65,095	18,757
Metal products---	13,484	984,915	468,654	459,032
Machine building industry---	15,786	1,970,647	865,464	985,126
Transportation equipment manufacture---	2,354	271,836	140,289	118,729
Electric equipment and machinery---	3,489	405,635	265,595	125,605
Electronic and telecommunications equipment---	702	113,337	93,196	18,620
Instruments, meters and other measuring equipment---	599	49,857	30,779	16,707
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Note: Unit = 1,000 yuan  
Source: State Industry Survey Office, the State Council, *The Survey Materials of Industry in 1985 in the People's Republic of China*, Chinese Statistical Press, Beijing, Vol.7, April 1988, pp.150-151.



## Appendix 6 (continued)

The Size and Acquisition date of Installed Equipment by  
Original Value at the End of 1985 in Sample Rural  
Industrial Enterprises by Branch of Industry

	60's	50's	before 1949
Total	479,767	130,601	54,118
Light Industry	182,432	64,543	47,639
Using Farm Products			
As Raw Materials---	116,320	49,529	44,357
Using Non-farm Products			
As Raw Materials---	66,112	15,014	3,282
Heavy Industry	297,335	66,058	6,479
Excavating	22,540	5,511	669
Raw materials	73,953	16,217	1,691
Processing	200,842	44,330	4,119
Branch of Industry			
Coal mining			
and dressing---	10,878	1,832	217
Ferrous metals			
mining and			
dressing----	1,215	131	--
Non-ferrous			
metals mining			
and dressing---	1,570	420	90
Building materials			
and other			
non-metal mineral			
products---	8,822	3,120	362
Salt mining---	485	159	--
Logging and			
transport of timber			
and bamboo---	54	8	--
Production and			
supply of			
running water---	159	59	--
Food manufacture---	26,440	5,388	664
Beverage manufacture---	3,010	741	138
Tobacco processing---	30	6	6
Forage Processing---	261	116	--
Textiles---	51,010	33,354	40,848
Clothing ---	5,367	1,528	248
Leather, furs and			
manufactured goods---	1,730	247	40
Timber processing			
and bamboo, cane,			
palm fibre and			
straw products---	5,955	1,171	146

Furniture manufacture--	5,203	919	119
Paper-making and			
manufactured goods---	14,871	4,640	1,142
Printing---	5,286	2,007	920
Manufacture of articles			
for culture,			
education and sports---	1,437	456	78
Manufacture of articles			
for arts and crafts---	1,632	403	152
Production and supply			
of power generation,			
Steam and hot water---	42,689	5,535	113
Petroleum processing---	111	39	--
Caking, gas and			
coal-related products--	175	50	--
Chemical industry---	7,466	2,089	318
Medical and pharmaceuti			
industry---	796	7	10
Chemical fibres			
industry---	1,214	166	124
Rubber manufactured			
goods---	3,645	1,846	361
Plastic manufactured			
goods---	11,987	4,280	1,297
Manufactured goods			
of building materials			
and other non-metal			
minerals---	83,789	18,341	1,313
Smelting and pressing			
of ferrous metals---	8,372	4,009	869
Smelting and pressing			
of non-ferrous metals--	2,120	367	10
Metal products---	47,575	8,989	665
Machine building			
industry---	96,452	21,408	2,196
Transportation			
equipment manufacture--	10,326	2,270	222
Electric equipment			
and machinery---	11,419	2,804	212
Electronic and			
telecommunications			
equipment---	1,308	200	13
Instruments,			
meters and other			
measuring equipment---	1,975	330	66
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Note: Unit = 1,000 yuan  
Source: As above.

**Appendix 7. The Size and Acquisition date of Installed Equipment by Original Value at the End of 1985 in Sample Rural Industrial Enterprises by Branch of Industry (% share per period)**

	80's	70's	before 70's
Total	61.10	34.77	4.13
Light Industry	67.58	27.36	5.07
Using Farm Products			
As Raw Materials---	70.55	24.14	5.31
Using Non-farm Products			
As Raw Materials---	61.23	34.22	4.55
Heavy Industry	57.44	38.96	3.60
Excavating	64.50	32.34	3.15
Raw materials	56.36	40.34	3.31
Processing	56.91	39.30	3.78
Branch of Industry			
Coal mining			
and dressing---	66.7	31.29	2.64
Ferrous metals			
mining and			
dressing----	64.49	31.44	4.07
Non-ferrous			
metals mining			
and dressing---	64.48	32.83	2.69
Building materials			
and other			
non-metal mineral			
products---	62.02	33.99	3.99
Salt mining---	45.44	49.42	5.14
Logging and			
transport of timber			
and bamboo---	67.41	30.30	2.29
Production and			
supply of			
running water---	73.83	23.11	3.06
Food manufacture---	68.60	26.99	4.41
Beverage manufacture---	76.28	22.32	1.40
Tobacco processing---	48.18	46.54	5.28
Forage Processing---	78.49	19.85	1.66
Textiles---	76.11	16.55	7.34
Clothing ---	76.86	20.56	2.57
Leather, furs and			
manufactured goods---	76.76	20.46	2.77
Timber processing			
and bamboo, cane,			
palm fibre and			
straw products---	58.34	36.86	4.79



Furniture manufacture--	53.83	40.31	5.86
Paper-making and			
manufactured goods---	53.49	42.68	3.82
Printing---	69.77	23.57	6.65
Manufacture of articles			
for culture,			
education and sports---	68.48	28.60	2.92
Manufacture of articles			
for arts and crafts---	70.93	25.79	3.28
Production and supply			
of power generation,			
Steam and hot water---	37.58	57.68	4.74
Petroleum processing---	57.91	40.94	1.15
Caking, gas and			
coal-related products--	72.32	26.24	1.43
Chemical industry---	64.93	33.02	2.05
Medical and pharmaceuti			
industry---	75.14	22.68	2.18
Chemical fibres			
industry---	83.88	14.02	2.10
Rubber manufactured			
goods---	62.99	31.40	5.61
Plastic manufactured			
goods---	74.34	22.27	3.39
Manufactured goods			
of building materials			
and other non-metal			
minerals---	63.87	33.82	2.30
Smelting and pressing			
of ferrous metals---	71.33	24.15	4.52
Smelting and pressing			
of non-ferrous metals--	75.39	21.72	2.89
Metal products---	47.58	46.61	5.81
Machine building			
industry---	43.92	49.99	6.09
Transportation			
equipment manufacture--	51.61	43.68	4.72
Electric equipment			
and machinery---	65.48	30.97	3.56
Electronic and			
telecommunications			
equipment---	82.23	16.43	1.34
Instruments,			
meters and other			
measuring equipment---	61.73	33.51	4.76
-----			

Note: Unit = %  
Source: As above.

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